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JOHN T. FEY, Clerk

In the Supreme Court of the United States

OCTOBER TERM, 1956

No.— 459

INTERSTATE POWER COMPANY, NORTHERN STATES POWER COMPANY, CENTRAL NATURAL GAS COMPANY (SUCCESSOR TO WESTERN STATES UTILITIES COMPANY), MINNESOTA VALLEY NATURAL GAS COMPANY, NORTH CENTRAL PUBLIC SERVICE COMPANY, KANSAS CITY POWER & LIGHT COMPANY (PEOPLES' GAS & ELECTRIC DIVISION), MINNEAPOLIS GAS COMPANY, STATE OF MINNESOTA, CITY OF ST. PAUL, MINNESOTA, CITY OF MINNEAPOLIS, MINNESOTA,

Petitioners

vs.

FEDERAL POWER COMMISSION,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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STATUTES:

Natural Gas Act, Act of June 21, 1938, 52 Stat. 821, 15 U. S. C., §§717-717w; as amended by Act of February 7, 1942, 56 Stat. 83, 15 U. S. C., §717f, and Act of July 25, 1947, 61 Stat. 459, 15 U. S. C., §717f(h), and Act of March 27, 1954, 68 Stat. 36, 15 U. S. C., §717:
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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this case on July 9, 1956. The judgment below also included the case of Northern Natural Gas Company, Petitioner, v. Federal Power Commission, Respondent, which cases have common issues. In the Court of Appeals the two cases, Civil 15412 and Civil 15424, were consolidated for hearing and opinion.

OPINIONS BELOW

The order and opinion of the Federal Power Commission (Commission) (R. 91-134)[1] is reported at 9 PUR 3rd Series, page 8 (Appendix A, pp. 18-55)[1]. The opinion of the United States Court of Appeals for the Eighth Circuit is reported at — F. 2d — (Appendix B, pp. 56-81).

JURISDICTION

The judgment of the Court of Appeals was entered on July 9, 1956 (Appendix C, p. 82). The jurisdiction of that Court was invoked under 15 U. S. C., §717r(b), 52 Stat. 831. A timely application for rehearing was denied by the Court of Appeals on August 10, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., §1254(1), 62 Stat. 928, and 15 U. S. C., §717r(b), 52 Stat. 831.

QUESTIONS PRESENTED

1. Does the Commission have the authority, to remove alleged undue discrimination, to order a natural gas company to increase its rates to several of its wholesale utility customers over those being charged in accordance with the currently effective rate schedule of such natural gas company on file with the Commission, upon the authority of *United Gas Pipe Line Company v. Mobile Gas Service Corporation,* 350 U. S. 332, absent any finding that such rate is so low as to conflict with the public interest and notwithstanding the proviso of §5(a) of the Natural Gas Act (15 U. S. C., §717d(a)) expressly prohibiting the Commission from ordering "any increase in any rate contained in the currently effective schedule of such natural gas company

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[1] The record references, R. 91-134, and other similar references are to the first two of three printed volumes. The third volume, pages 1 through 514, contains exhibits only and references to that volume will read, for example, R. III, 550. App. means Appendix.

on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company * * *"?

2. Does the action of the Commission in (a) finding a long-established, uniform rate of a natural gas company to be unduly discriminatory and preferential; (b) finding zone rates not to be unduly discriminatory or preferential, and (c) establishing zones and rate differentials, such findings being based on material facts not in the record, without giving petitioners an opportunity after timely request to present rebuttal evidence or cross examine thereon, deprive petitioners of their property without due process of law, contrary to the Fifth Amendment to the Constitution of the United States, and violate §§7(c) and (d) of the Administrative Procedure Act, 5 U. S. C., §§1006(c) and 1006(d)?

3. Do the decisions of the Commission and the Court below, that the long established, uniform rate of Northern Natural Gas Company is unduly discriminatory and preferential, and that zone rates, based on allocating transmission costs on distance only, are not unduly discriminatory or preferential, ignore and conflict with the decision of this Court in *Colorado Interstate Gas Company v. Federal Power Commission* (1945), 324 U. S. 581?

STATUTES INVOLVED

The statutory provisions involved are §§7(c) and 7(d) of the Administrative Procedure Act, 60 Stat. 241, 243; 5 U. S. C., §§1006(c), 1006(d); §§4(b), 5(a) and 19(b) of the Natural Gas Act, 52 Stat. 822, 823, 831; 15 U. S. C., §§717c(b), 717d(a), 717r(b) (Appendix D, pp. 83-85).

STATEMENT

A. Procedural history.

The proceedings before the Commission arose out of proposed increases in rates reflected in revised tariff sheets filed by Northern Natural Gas Company (Northern) with the Commission on June 24, 1953 (R. 60), such tariff sheets providing, as has been done since the adoption of the Natural Gas Act in 1938, for uniform, system-wide rates to all resale customers, except in the Argus System in Kansas (R. 60, 140-144). The Commission, under §4 of the Natural Gas Act, Northern admittedly being a natural gas company under the Act, (App. A, p. 50) initiated a hearing and temporarily suspended the effectiveness of such rate increases (R. 60). Numerous wholesale customers of Northern, including these petitioners, were permitted to intervene (R. 133-140). Two customers, Council Bluffs Gas Company and Central Electric & Gas Company, alleged that, as to them, Northern's system-wide rates were unduly discriminatory and preferential (R. 60). Each of the companies named as petitioners here, all opposed to zone rates, are public utilities purchasing their entire supply of natural gas from Northern and distributing natural gas at retail in many communities in northern Iowa and southern Minnesota (R. 217-266).

A settlement agreement of the parties, covering the justness and reasonableness of the rate level and the allocation between jurisdictional and nonjurisdictional customers, was approved by the Commission on January 28, 1954, and provision was made for a hearing on zone rates (R. 155-169) covering the allocation of jurisdictional costs among jurisdictional customers. On November 18, 1955, the Presiding Examiner's decision found that Northern's uniform rates were not unduly discriminatory nor preferential and that

the public interest did not require the establishment of zone rates (R. 58-91). After filed exceptions to such decision and oral argument, Commission Opinion No. 281 was issued May 20, 1955. The Commission found Northern's uniform rates to be unduly discriminatory and preferential, prescribed zone rates and differentials, and found such zone rates not unduly discriminatory nor preferential (R. 91-126). It ordered Northern to file revised tariff sheets amending its then currently effective rate schedules to reflect zone rates (App. A, pp. 53-54).

The timely filed applications of Northern and petitioners for rehearing were denied by the Commission on July 12, 1955 (R. 207-208).

On August 19, 1955, these petitioners filed in the United States Court of Appeals for the Eighth Circuit a joint Petition to Review said decision, which case was docketed in that court as Interstate Power Company, et al. v. Federal Power Commission (R. 1-42). On September 9, 1955, Northern filed in the United States Court of Appeals for the Eighth Circuit a Petition to Review said decision, which case was docketed as Northern Natural Gas Company v. Federal Power Commission (R. 42-58). On July 9, 1956, the Court below affirmed the order of the Commission and entered judgment. A timely Petition for Rehearing, filed by these petitioners, was denied on August 10, 1956. The Court below stayed its mandate to October 19, 1956, by order entered August 28, 1956.

B. Factual statement, question 1.

At the time of the filing of the Commission's Opinion and Order No. 281, May 20, 1955, Northern was charging its wholesale customers, pursuant to its duly filed and currently effective tariff, a rate of $2.70 per month per Mcf of billing demand and 22.1¢ per Mcf of gas deliv-

ered (R. 227). This rate was effective under bond, subject to refund (App. A, p. 46). The Commission ordered Northern, over its objections, to file revised tariff sheets providing for zone rates with a differential of 2¢ between each zone based on a 70% load factor, Zone 1 having the lowest rate and Zone 3 the highest rate. The order provided: "Northern * * * *shall* file with the Commission revised tariff sheets * * * satisfactory to the Commission" providing for rate differentials between the three zones (App. A, p. 53). It further ordered that the rate shall produce revenues from jurisdictional sales not to exceed $86,538,101 as provided in Northern's new rate increase filing of July 2, 1954 (App. A, p. 54). Northern, pursuant to and as required by this order, filed revised tariff sheets effective June 27, 1955, establishing rates in the three zones with differentials (R. 228-230). In Zone 3, in which these petitioners purchase gas from Northern, the rate became on that date $2.88 per month per Mcf of billing demand and 22.1¢ per Mcf of gas delivered (R. 230). The Commission, by order issued August 2, 1955, accepted the revised tariff sheets as filed by Northern as being in compliance with its mandatory order of May 20, 1955 (R. 211).

The result of such increase in rates to the customers in Zone 3, including these petitioners, was to require such customers to pay Northern approximately $1,225,000 per year more than they would otherwise be required to pay by the rate in the then currently effective schedule of Northern.

C. Factual statement, question 2.

The Commission, using the 1954 agreed cost of service, approved a mathematical formula submitted by a Staff witness to allocate transmission costs between zones. The essence of the formula consists of: (a) multiplying the 3-day

peak average volumes and the annual volumes by the pipeline miles for each sales point; (b) dividing total system transmission costs by total system pipeline miles to obtain system unit cost; and (c) multiplying each zone's pipeline miles by the system unit transmission cost to obtain assumed zone transmission costs (App. A, pp. 42-45).

Within eight days after the record in this hearing closed, to-wit, on July 2, 1954, Northern filed a new rate increase on a uniform, system-wide basis (App. A, p. 46). This increased rate became effective, under bond, December 27, 1954 (App. A, p. 46). The Commission used the extra-record material contained in this filing to support its order. Without this material the order and the filing of the required revised tariff sheets by Northern could not have been made (App. A, pp. 46-47). The Commission, with reference to the new cost of service, said that it applied the principles and methods of cost classification and allocation found to be proper (App. A, p. 47). The Court in its decision said, in effect, the same (App. B, p. 73). The material filed by Northern on July 2, 1954, being on a uniform rate basis only, did not contain the factual data necessary for use in allocating the transmission cost by the mileage demand method approved and adopted. To allocate the transmission costs for a given period by this method, it is necessary that the following factual data be available (R. 928):

(a) The annual sales volume to each delivery point on the system;

(b) The 3-day peak average sales volume to each point on the system;

(c) The number of pipeline miles to each delivery point on the system.

None of the facts listed in (a) or (b) for the new period used are anywhere to be found in this record, and the mile-

ages to approximately 30% of the total delivery points on the system were obtained by resorting to extra-record material (App. B, p. 74), as to which petitioners were denied the opportunity to show that the actual mileages were other than those used by the Commission. Additionally, the zone lines delineated by the Commission were neither presented in evidence during the hearing nor was opportunity afforded petitioners to point out defects in such selection after timely request therefor (R. 32, 195).

D. Factual statement, question 3.

The reason given by the Commission for its use of the mathematical formula described above is the economic fact that the delivery cost of natural gas increases in close proportion to the length of a transmission line of any *given size* (App. A, p. 35).

Northern's transmission system is not of a "given size" since it contains approximately 2,000 miles of branch line and 3,200 miles of main line (R. 722). The northerly 400 miles, which includes the principal market area, contain pipe varying in diameter from 2⅜ inches to 30 inches (R. III, 40-42). Nevertheless, in the formula used by the Commission the same unit of transmission cost was applied to every mile of pipe (R. 721, 723, 956-957, 993), although the unit delivery cost of natural gas decreases in close proportion to the increase in the size of a transmission pipe of any given length (R. 79, 449-450, 559, 593-599; R. III, 427-429). Northern's transmission system has been one of a given length, to-wit, 800 miles since 1933 (App. A, p. 22; R. III, 64, 66, 69-70).

The average cost per Mcf to Northern's wholesale customers decreased 11¢ per Mcf from 1939 through 1950 (R. III, 425). This reduction was generated by the application of the simple economic fact, as stated above, that

unit costs decrease with larger volumes and larger size pipe on a line of any given length (R. 712). The customers in Zone 3 for 1954 purchased 55% of all sales for resale (R. III, 549-555). The Commission admits that these large volumes contribute to lower the unit transmission cost and thus benefit everybody on the line (App. A, p. 30) but refused to recognize such fact in allocating the transmission costs among the wholesale customers of Northern.

The mathematical formula of allocating transmission costs to zones does not purport to result in the actual transmission cost for a zone. The witness Curry, who sponsored this method, admitted it was not based upon a cost of service study in each zone (R. 926).

Northern's transmission system was originally designed to serve the Twin Cities market of Minnesota (R. 140-145; R. III, 417, 424).

The uniform rate has been in effect since the adoption of the Natural Gas Act (R. 140-145).

There has been no change in the general economics of the area served by Northern in the past several years; and no substantial change in the load distribution on the system; and no substantial change in the basic overall pattern of the main line system or in the market area since the initial installation of the system (R. 404, 707, 708, 710).

REASONS FOR GRANTING THE WRIT

1. Question 1 (Violation of the proviso of §5(a)). The Commission and the court below interpreted the prohibition of Commission power, as contained in the proviso of §5(a) of the Natural Gas Act, 15 U. S. C., §717d(a), contrary to the plain Congressional intent and to the clear and unambiguous language of the proviso. This Court has not previously decided the true interpretation of the proviso of §5(a) and it is essential that this important question of fed-

eral law, vital to millions of users of natural gas in the United States, should be settled by this Court.

The Court below cites *United Gas Pipe Line Co. v. Mobile Gas Service Corp.* (1956), 350 U. S. 332, and quotes *inter alia*, the following language of this Court (p. 345):

> "* * * if the Commission after hearing, determines the contract rate [of a natural gas company] to be so low as to conflict with the public interest, it may, under Section 5(a), authorize the natural gas company to file a schedule increasing the rate,"

to sustain the contention of the Commission that the proviso of §5(a) did not affect its power to require Northern to increase its rate in Zone 3.

The decision of the Court below is believed to be erroneous in its reliance upon the language of this Court in the *Mobile* case. In that case, this Court pointed out that the Commission could *authorize* a natural gas company to file a schedule increasing *a contract rate* if, upon petition by the natural gas company, and after hearing, the Commission should determine such contract rate to be so low as to conflict with the public interest. But here, *there is no finding* by either the Court or Commission, that Northern's rate was "so low as to conflict with the public interest". Moreover, it is not apparent from the above-quoted language in the *Mobile* decision that this Court meant to empower the Commission to *order* or *direct* a natural gas company, over its objections, to file a new rate schedule increasing the rates contained in effective schedules of such company then on file with the Commission (as was done in the instant case) notwithstanding the prohibition contained in the proviso of §5(a) of the Act.

Both the Commission and the Court of Appeals conclude that the word "rate", as used in the proviso, means "total revenues" (App. B, p. 64). It is true in this case that the

Commission's order prescribing zone rates did not increase the total revenue being collected by Northern under its currently effective rate schedule. But it did increase the actual rate, or the charge being made for the service rendered, to these petitioners over the actual rate contained in the currently effective schedule of Northern. The word "rate" means the price stated or fixed for the commodity sold; it means the amount which the customer must pay the utility for the service he receives. See *Portland Gas Light Company* (1947), 69 PUR (NS) 154, 156; *Lenawee County Gas & Electric Company v. Adrian* (1920), 209 Mich. 52, 176 N. W. 590; *City of Detroit v. Public Utilities Commission* (1939), 288 Mich. 267, 286 N. W. 368, 373.

The question presented is of great importance. It relates to the construction and administration of the Natural Gas Act. This case is of first impression. Not until now has the Commission asserted authority to order a natural gas company to increase any rate contained in the currently effective schedule of such company. Such assertion of power conflicts with prior rulings of the Commission.[2] Settlement by

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[2] Significantly, the Commission has heretofore stated:

"The proviso of §5(a) of the act is clear and unambiguous. Thus, without more, there would be no occasions to resort to the legislative history to ascertain the congressional intent with respect to this proviso. Even so, because of the importance of this proviso in this case, and the seriousness of the arguments made with respect to the interpretation to be given it, we have closely examined the legislative history of the Natural Gas Act. Upon such examination, we find nothing to indicate that it was the intent of the Congress to give to the language of the proviso any meaning other than that generally given to these words. Accordingly, we conclude that the Commission has no power to order an increase in the costs of gas to certain of applicants' customers, which would result by the application of the rates and charges herein found to be just and reasonable as to other customers, when coupled with a heat content adjustment provision." (*In the Matter of Atlantic Seaboard Corporation, et al.* (1952), 94 P. U. R. (N. S.) 235, 256).

this Court, therefore, of the question of the Commission's authority in the premises is plainly in the public interest, since the authority conferred by the Court below will be utilized by the Commission in future proceedings involving the removal of alleged undue discrimination among customers of natural gas companies.[3]

2. Question 2 (Violation of the due process clause and the Administrative Procedure Act). The Commission, with the approval of the court below, did not comply with the mandatory provisions of the Administrative Procedure Act in the hearing on zone rates. It is essential for this Court to exercise its power of supervision to rectify the error made. The decision of the Court of Appeals, approving the denial of a fair hearing, is in direct conflict with applicable decisions of this Court.

See also *In re Colorado Interstate Gas Company* (1952), 95 P. U. R. (N. S.) 97, where the Commission said (p. 126):

"* * * We have already held that, under §5(a) of the Natural Gas Act, 15 U. S. C. A., §717d(a), we are not permitted to order an increase in the rates to one customer in a rate proceeding, even though the effect of our order is to produce lesser total over-all revenues. Re Atlantic Seaboard Corp. (1952) Opinion No. 225, 94 PUR NS 235, 256."

And in its report to the Congress for the year 1954 the Commission recommended that Section 5(a) be amended to provide authorization for it to increase rates where necessary to correct undue discrimination. No amendment to Section 5(a) has become law (F. P. C. Annual Report to the Congress, 1954, p. 170). The Commission also made the same recommendation in its annual report for 1955 (F. P. C. Annual Report, 1955, pp. 181, 182).

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[3] Compare the decision of the United States Court of Appeals for the Eighth Circuit in *Panhandle Eastern Pipe Line Co. v. Federal Power Commission* (1953), 204 F. 2d 675, 680, in which the Court held that, where Congress has specifically withheld the exercise of a power from the Commission, it cannot exercise that power even though the purpose is to remove discrimination. The Commission itself has just recently recognized this basic and fundamental principle of law in its decision (June 30, 1956) *In the Matter of Panhandle Eastern Pipe Line Co.*, Dockets G-1705, et al., Opinion 292 (pp. 12-15, mimeo copy).

§7(d) of the Administrative Procedure Act, 5 U. S. C., §1006(d), provides:

> "* * * Where an agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary."

The extra-record matters used by the Commission were material facts, for without the use of such facts, to-wit, the 1955 cost of service plus the pipeline miles to the 70 new communities, the decision, as rendered, could not have been written. The following facts, all in the record for 1954, are absent from the record for 1955, and petitioners were denied "an opportunity to show the contrary":

1. The number of miles of pipeline haul to the 70 new communities.
2. The 3-day system peak average sales volumes to all delivery points on the system (306 delivery points, (R. III, 549-555), plus 70 new communities).
3. The annual sales volumes to all delivery points on the system.
4. The system-wide unit production cost.
5. The system-wide unit transmission cost.
6. The total number of pipeline miles in Zone 3, since the zone rates selected in the Commission's decision were never placed in the record.
7. The production costs in Zone 3.
8. The transmission costs in Zone 3, as arrived at by the mathematical formula approved.

This Court has frequently disapproved of such procedure by rate-making bodies. See *Interstate Commerce Commission v. Louisville & Nashville Railroad Company* (1913), 227 U. S. 88; *United States, et al. v. Abilene & Southern Railway Company, et al.* (1924), 265 U. S. 274;

Ohio Bell Telephone Company v. Public Utilities Commission (1937), 301 U. S. 292.

The decision of the Court below that the admitted use by the Commission of extra-record material in its opinion and order was not a denial of due process or a violation of the Administrative Procedure Act presents a question of vital importance in the entire field of administrative law. The decision of the Court upon this question was based upon its finding that the use of material drawn outside the record in the instant case did not prejudice the petitioners.[4] No authority was cited by the Court for its conclusion in this regard and no reference was made by the Court to relevant provisions of Sections 7(c) and 7(d) of the Administrative Procedure Act. The importance of this action cannot be over-emphasized. The effect of the ruling of the Court below is that an order of an administrative agency may rest on material facts not appearing in the evidence of record without granting to the affected parties the right to refute such extra-record material by cross examination or otherwise. The ruling affects the rights of every person appearing before a board, commission or agency.

The decision of the Court below is believed to be erroneous in requiring that prejudice be shown on the record before a party may challenge an order of the Commission which is based, in part, on material facts not appearing in the record.[5] Opportunity was not afforded these petitioners

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[4] The Court characterizes some of the extra-record material used by the Commission as being "record evidence * * * furnished by Northern in Docket G-2505 and Docket G-2063" (App. B, p. 73). Docket G-2505 involved the July 2, 1954, filing by Northern hereinabove mentioned, and no hearing had been held as of the time of the Commission opinion. Therefore, there could be no "record evidence," of matters contained in such filing.

[5] This Court has held in *Simmons v. United States* (1955), 348 U. S. 397, that where a statutory requirement, enacted to guarantee a fair hearing, is violated, the petitioners do not have to show prejudice.

to show prejudice, for the record was closed before the extra-record material relied on by the Commission in its opinion and accompanying order was first brought to the attention of these petitioners.[6] Petitioners made a timely request to the Commission for an opportunity to show that the extra-record material was in error and were denied such opportunity (R. 172-205; 207, 208). The Court below states that, even if it be true that the Commission erred, the petitioners have an opportunity to demonstrate such error to the Commission for consideration and correction by it in a future proceeding (App. B, p. 74). No authority is cited by the Court for this proposition. Where, as here, the Commission relies on its decision on material facts not in the record and denies to petitioners the right to rebut such facts, the provisions of Section 7(d) of the Administrative Procedure Act are clearly violated.

3. Question 3 (Conflict with the *Colorado Interstate* case). The record shows that the distance of transmission is the only factor upon which the two studies recommending zoning were based (R. 417-419; 926; 944; 966-968; 970; 1011). The Commission's and the Court's decisions justify allocating transmission costs on the mileage demand basis because of distance (App. A, p. 35; App. B, p. 67).

These decisions are in direct conflict with this Court's decision in *Colorado Interstate Gas Company v. Federal Power Commission* (1945), 324 U. S. 581. That decision involved the same question presented here: a fair method of allocating transmission costs of a natural gas company among its customers. The essence of that decision is that considerations of fairness and not mere mathematics govern the allocation of costs (324 U. S. at p. 591). Complaint was

[6] The fact is that the petitioners were substantially prejudiced by the Commission's order, in that their cost of gas at the city gate was materially increased ($464,000 for last six months of 1955).

made in that case, as here, that customers near the source of supply were burdened with too large a share of transmission costs, when such costs were allocated on a system-wide basis. But this Court answered it could "see in this situation no difference between those customers and the ones located at more distant points on the pipeline" (324 U. S. at pp. 591, 592). This Court further said in that case that, by allocating transmission cost on a system-wide basis, rather than on a mileage demand basis, the beneficiaries of the entire project share equitably in the cost (324 U. S. at p. 591). Neither the Commission nor the Court below gave due recognition to or followed the principles of transmission cost allocation established by this Court in the *Colorado Interstate* case, *supra*.

The record shows that for 1954 Zone 1 customers purchased but 1% of the total sales for resale. Yet, those customers enjoy the lowest rate under the Commission's zone plan solely because they are nearer the source of supply (R. 228-230). These customers in Zone 1 are the beneficiaries of the entire project. Without the volumes transported through Zone 1 and distributed in Zones 2 and 3 (99% of the total for 1954), the customers in Zone 1 would not have enjoyed the low rate which they paid under the uniform, system-wide rate. The same can be said for the customers in Zone 2, for without the volumes of gas sold in Zone 3, which volumes created the necessity for the larger diameter pipe, the unit transmission cost to the customers in Zone 2 would have been greater (R. 712, 813).

It is not fair to require the customers in Zone 3, thousands of whom became attached to the system under the uniform rate, to now pay a higher rate. The Commission admits that the presence of these customers in Zone 3 on the system helps lower the unit cost of transmission (App. A, p. 30). This being so, all of the customers on the system are the

beneficiaries of the integrated operation. They should all share equitably in the transmission costs by paying the uniform rate (R. 141, 142, 1026, 1027).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for the writ be granted.

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APPENDIX A

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Claude L. Draper, Nelson Lee Smith, Seaborn L. Digby and Frederick Stueck.

Docket No. G-2217

In the Matter of Northern Natural Gas Company

OPINION NO. 281

OPINION AND ORDER PRESCRIBING RATE ZONES AND RATE DIFFERENTIALS

This matter is before us upon exceptions to and appeals from the Intermediate Decision of the Presiding Examiner as filed herein on November 12, 1954. There is to be decided a single issue presented by the proposals of certain intervening parties that service zones be established on the system of Northern Natural Gas Company (Northern) and that differentials in rates be fixed for service in such zones.

The proceeding arose out of the filing on June 26, 1953, by Northern of proposed revised sheets to its FPC Gas Tariff to provide increases in rates and charges for the sale of natural gas for resale. By order issued on July 24, 1953, pursuant to Section 4 of the Natural Gas Act, the Commission, upon its own motion, suspended and deferred the use of such proposed revised sheets.

Pursuant to Commission order, hearings were held on October 26, 27, and 28, 1953, at which Northern presented evidence purporting to support its proposed increased rates and charges. Thereafter, on January 21, 1954, following conferences among the parties to the proceeding, final agreement was reached by the parties respecting all matters involved and issues presented in the proceeding, excepting the single issue respecting rate zones and rate differentials.

The agreement of the parties was reflected in a statement approved by the Commission by order issued January 28, 1954, which required Northern to file revisions of its FPC Gas Tariff to accord with the approved settlement. This order, as contemplated by the approved settlement, also directed that further hearing be held in this proceeding respecting service zones and differentials in rates.

Pursuant to such order issued January 28, 1954, hearings on the issue now before us were held commencing on March 22, 1954, and, with necessary recesses thereof, concluding on June 24, 1954. A large number of parties were permitted to intervene and participate in the proceedings. Their identity is disclosed at a further point herein.

The Presiding Examiner filed a Decision in this matter on November 12, 1954, which was issued on November 18, 1954. Thereafter, pursuant to Section 1.31 of the Rules of the Commission, Central Electric & Gas Company (Central), Council Bluffs Gas Company (Council Bluffs), and the Metropolitan Utilities District of Omaha (M.U.D.), interveners, acting jointly, and Commission Staff Counsel, filed exceptions to and appeals from the Decision. Oral argument on these exceptions and appeals was heard by the Commission on February 17, 1955.

It is the position of Central, Council Bluffs, and M.U.D.,[1] that Northern's present tariff, which provides uniform system-wide rates to all resale customers, excepting the so-called Argus System,[2] is unduly discriminatory as to them and preferential as to others of Northern's customers; and that the only fair, practical, and equitable means for the elimination of the unduly discriminatory rates is the adoption of service zones and zone rate differentials. The Staff

[1] This coalition of Council Bluffs, Central, and M. U. D. is hereinafter sometimes referred to as the "Proponents".

[2] The area often referred to as the Argus system comprises facilities of Northern in and near the Hugoton Field used for the sale of gas to communities in this area.

also is of the opinion that Northern's tariff is unduly discriminatory and preferential, and that such discrimination and preference should be eliminated by the fixing of service or rate zones and differentials in rates. The Proponents and the Staff, however, have different views as to the proper boundaries for such zones, as well as the appropriate differentials in rates between zones.

All other interveners participating in the proceeding and Northern are opposed to the establishment of zones. These interveners, the State of Minnesota, City of Minneapolis, City of St. Paul, Northern States Power Company, Minneapolis Gas Company, Minnesota Valley Natural Gas Company, Western States Utilities Company, Iowa Public Service Company and Iowa Electric Light & Power Company[3] joined forces to present evidence and argument opposed to the establishment of zones on Northern's system, and rate differentials.

In the Decision filed November 12, 1954, the Presiding Examiner found and concluded, among other things, that:

> "(18) Northern's current uniform system-wide rates, which became effective December 27, 1953, have not been shown to be so unjust, unreasonable, unduly discriminatory or preferential as to constitute a violation of Section 5(a) of the Natural Gas Act.
>
> "(19) The public interest does not now require the establishment of service zones or zone rates upon the interstate natural gas system of Northern Natural Gas Company."

Although having thus stated a negative finding and conclusion as to the main question in the case, the Presiding Examiner expressed in the Decision his findings and conclusions as to other questions which he did not properly reach in view of his recommended disposition of the basic issue. Naturally, since these extraneous expressions of opinion—having the nature of dicta—are opposed to their contentions, the Proponents and the Staff appeal therefrom as well as from the findings and conclusions upon the basic issue.

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[3] Sometimes hereinafter collectively referred to as the "Opponents".

A proposal to establish zones and rate differentials on Northern's system was previously presented by Council Bluffs in earlier proceedings involving rates of Northern at Docket Nos. G-1382, et al. In our Opinion No. 228 issued June 11, 1952, in those proceedings it was stated (page 31, mimeo. ed.):

> "Zone Rates: Northern at present has system-wide rates with the exception of its sales in the Hugoton area * * *. Council Bluffs advocated zone rates for Northern's sales. In support of its contention, Council Bluffs presented detailed studies of proposed zones, with cost of service and allocation of costs by zones and proposed specific zone rates. However, on a system as complex as Northern's the determination of proper zone rates, to our mind, requires more thorough and exhaustive study. Other methods of allocating costs between zones might be more reliable than the pipe-line mileage method utilized by Council Bluffs. Moreover, the delineation of zones requires scrupulous care if such zones are not to be arbitrary or discriminatory. Council Bluffs' witness, who prepared these studies conceded, upon cross examination, that his use of state lines as zone boundaries was arbitrary and that other boundaries might reasonably be fixed. For the foregoing reasons, and from our examination of the record, we do not believe that there is sufficient evidence before us to determine at this time whether zone rates for Northern's system are in fact proper, and if so, what such zones and such rates should be. There is now pending a proceeding upon a proposed rate increase by Northern in Docket No. G-1881 and we think it appropriate that the problem of zone rates be explored in that proceeding."[4]

Since only limited hearings were held in the proceedings at Docket No. G-1881 mentioned in the above quotation,

[4] Upon review, the United States Court of Appeals cited this part of the opinion with approval. *Northern Natural Gas Co. v. Federal Power Commission*, 206 F. 2d 690, 712 affirming F. P. C. Op. No. 228 in pertinent part and reversing in part; cert. denied 346 U. S. 922.

an opportunity was not there afforded to further develop the matter of zoning. At the first opportunity thereafter presented, being this instant proceeding, Council Bluffs again raised in its petition for leave to intervene the issue respecting the establishment of zones and rate differentials, as did Central. Thereafter, M.U.D. joined with the other two interveners in urging the fixing of zones and rate differentials, and in the joint presentation of evidence in support of this position.

Extensive evidence was presented by the parties favoring the establishment of zones and rate differentials—as well as by those opposed thereto. The Staff of the Commission, although it took no position during the hearing in the matter,[5] presented evidence designed to aid in the resolution of this issue. The record made in the sixteen days of hearing devoted to this single question includes 46 exhibits, many of which are quite voluminous, and over 2,000 pages of testimony. There is ample evidence before us at this time upon which to reach a decision, unlike the inadequate state in which we found the record in earlier proceedings where the zoning question was first broached. (See F.P.C. Opinion No. 228, supra, page 31.)

Northern's pipe-line system is about 800 miles in length, extending from the Panhandle Field in Texas and the Hugoton Field in Kansas and Oklahoma to a point near the Twin Cities of St. Paul and Minneapolis. In addition to the gas purchased from producers in these fields, Northern also takes delivery of substantial volumes of gas near Wasson, Texas, from Permian Basin Pipeline Company (Per-

[5] At the outset of the hearing on this particular phase of the proceedings, and on several occasions thereafter, Staff Counsel stated that the Staff, as such, would take no position during the hearing either in favor of or in opposition to the establishment of zones on Northern's system. It was stated to be the Staff's purpose in the hearing to secure the development of a comprehensive record upon which ultimate decision could be made by the Commission: First, as to whether zones should be established; and, second, in the event it be found that they should be, an appropriate basis for fixing zones and rate differentials. The Staff first announced its position favoring zones in the initial brief filed herein.

mian), a subsidiary of Northern.[6] Permian, in turn, purchases natural gas in the Permian Basin area in west Texas and eastern New Mexico—some 400 miles south of the other fields supplying Northern. Thus, Northern's system is, in effect, extended to a distance of about 1,200 miles.

Natural gas transported through this system is sold to other utilities at points in Kansas, Nebraska, Iowa, South Dakota, and Minnesota for resale to consumers in these states. Through its so-called Peoples Natural Gas Division, Northern also sells directly to consumers in each of these states. Excepting those sales made in and adjacent to the Hugoton Field, in Kansas, the rates charged by Northern for jurisdictional sales have historically been uniformly available and applicable. And, in proposing the increased rates which initially were the subject of this proceeding, Northern also designed rates to be applied uniformly to all sales for resale in Kansas, Nebraska, Iowa, South Dakota, and Minnesota.

At the time of the hearing in this matter, Northern was serving one distributing company in the State of Kansas. Deliveries to this customer, the Kansas Power & Light Company, are made at 15 separate points requiring transmission through Northern's facilities of distances ranging from 179 to 322 miles from the source of gas supply.[7] These sales in Kansas, however, represented only about 0.35 per cent of the total sales for resale estimated for the year 1954.

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[6] Northern owns approximately 83 per cent of Permian Basin Pipeline Company.

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[7] These mileage computations are based solely on miles of transportation through the facilities of Northern only, and do not include transportation by or for the account of Permian Basin Pipeline Company. In computing the mileage to the several points of delivery there was first determined the weighted average transmission miles of haul from the several sources of gas supply to a common point on Northern's transmission system. This was determined to be at Northern's Bushton (Kansas) Compressor Station, which is the last point of input into the system.

Northern, at the time of the hearing, also served twenty-six other utilities at 126 delivery points in the States of Nebraska, Iowa, South Dakota, and Minnesota. These sales constituted 99.65 per cent of Northern's total estimated jurisdictional sales in 1954. Deliveries in these states are made at point on Northern's system ranging from 390 to 803 miles from the source of gas supply. While, as noted, there are 126 of such delivery points, sales at the 8 points shown below represented over 71 per cent of Northern's total estimated jurisdictional sales in 1954.

Delivery Point	Estimated Annual Sales 1954 (Mcf)	Percentage of Total Annual Jurisdictional Sales	Percentage Load Factor of Sales	Weighted Average Miles of Haul—Transmission System
Lincoln	10,866,200	4.63	76.19	447.62
Omaha	26,345,000	11.23	78.27	480.61
Council Bluffs	6,053,600	2.58	77.02	483.96
Sioux City	9,826,400	4.19	75.87	560.46
Des Moines	25,352,400	10.81	81.75	625.91
Sioux Falls	7,358,800	3.14	81.10	642.92
Minneapolis	55,013,000	23.45	70.30	795.59
St. Paul	25,922,200	11.05	83.27	803.37
Total	166,737,600	71.08	76.41 Ave.	666.65 Ave.
Jurisdictional Sales System Total	234,588,200	100.00	76.38 Ave.	662.00 Ave.

Having in view the facts concerning the mileage of transmission through Northern's facilities required to effect deliveries to these and other points of sales, and considering particularly the fact that the cost of transmission represented 55 per cent of Northern's total estimated cost of service in 1954, as agreed upon in the approved settlement, the Proponents of zoning contend that Northern's present uniform, system-wide rate practice requires communities situated nearer the source of gas supply "to subsidize" those communities located more distant from the source of supply. This, it is argued, subjects the "subsidizing communities" to economic disadvantage and is preferential to others—and is undeniably undue discrimination forbidden by Sections 4 and 5 of the Natural Gas Act.

While conceding that factors other than distance of required transmission should be considered, such as load distribution, volumes of gas sold, and load factor of sales, the Staff contends that the distance that gas is required to be transported to the points of deliveries is a primary and important cause for the incurrence of transmission costs. Giving consideration to these several factors as related to the system of Northern, it is the position of the Staff that the application of uniform rates and charges throughout the large area served by Northern, exclusive of the so-called Argus System, subjects some of Northern's customers to undue discrimination and grants preference to others. This contention of the Staff is primarily based upon the fact that markets closer to the source of gas supply involve lesser transportation expense than more remote markets, and, therefore, are entitled to a lesser rate—unless it be shown that factors other than distance off-set the differences in transportation mileage and related costs. The Staff contends that there are no such off-setting factors in this case.

The Proponents of zoning likewise contend that where cost of transportation is a dominant factor as it is here, distance is a controlling factor in the absence of other countervailing factors. And, they further contend, there are no such countervailing factors in this case.

As opposed to these arguments, the parties opposed to zoning, including Northern, contend that there should be no change in Northern's long-continued practice of maintaining uniform rates throughout its system, excepting the Argus area, and of "rolling-in" in such uniform rates additional costs as they were incurred. It is said that this practice has been previously "approved and accepted" by the Commission, and that no good reasons have been herein shown for departing from this practice. In furtherance of this point of argument, the Opponents go to great lengths to demonstrate that the large volume of gas distributed on Northern's system, increasing through the years, has benefited all of Northern's customers through lowered transmission costs. They also urge that the large volume sales made in the upper reaches of Northern's system have

benefited customers closer to the source of gas supply, in that such latter customers enjoy a lower unit transmission cost than they otherwise would have without benefit of such sales on the system. From these and similar arguments, the Opponents conclude that by the uniform rate all of Northern's customers share "equitably" in the cost, and, that, therefore, the uniform rate should be continued.

The parties opposing zoning, including Northern, contend also that an increase in rates to some of the distributors occasioned by the establishment of zone rate differentials "will" result in the loss of interruptible industrial sales, and "that the loss of such customers will of necessity cause a raise in the demand charge and thereby all of the firm customers on Northern's system will be injured." The loss of sales, it is said, will result because such an increase in rates will price natural gas out of the competitive market, at least so far as some present industrial consumers are concerned.

Finally, we note the contention of these parties that the proposal to establish zones on this system is untimely and premature because: (1) Northern has pending before this Commission an application for authorization to import gas from Canada as an additional source of supply; (2) Northern, pursuant to limited authorization of the Commission, is exploring the possibility of developing a storage area at a point near its system; and (3) Northern has pending before the Commission applications for authorizations permitting the extension of its system into new markets in Minnesota, Wisconsin, and South Dakota. The Opponents further contend that: "Any one of the projects upon completion would certainly require another zone study."

We, of course, have not attempted to recite all of the varied arguments advanced by the opposing parties in support of their positions, but we have referred to those which are basic. Further allusion to the variations thereof at this point would not aid in our discussion, nor in an understanding thereof.

Attacking the problem from the rear, the Presiding Examiner first sought to determine which, if any, of the several zoning proposals submitted afforded the most feasible and least discriminatory method of establishing zones for service and rate determination purposes. Having determined that none of the proposals presented was satisfactory, and that his suggested alternative zoning was not wholly satisfactory, the Decision progresses to the point where it is found and concluded that:

> "It is impossible to find under the circumstances, and in view of probable early changes in both markets and sources of supply of Northern, that the present uniform system of rates on the system of Northern is unjust, unreasonable, unduly discriminatory or preferential."

And the Examiner goes on to say that:

> "While it is not believed that the time is now ripe for zoning of Northern's system, it is entirely possible and probable that at some time in the future zoning of the Northern system will be desirable and have the effect at that time of being less discriminatory and preferential than a uniform rates structure for the whole system."

The initial question to be decided, however, is not whether any of the zoning proposals are feasible, but, rather, whether the present rate structure of Northern is unduly discriminatory or preferential. If the finding is in the negative, as was the Examiner's, then it becomes immaterial whether the proposals as to zone boundaries are proper or not.

To clear the approach to a consideration of this basic question, we would make it clear that we consider the proposals of zoning neither untimely nor premature—if it be concluded that the existing rate practice of Northern is unduly discriminatory or preferential, and, therefore, contrary to the provisions of the Natural Gas Act. The purposes of the Act cannot be thwarted simply because at some indefinite time in the future the present scheme of operations of

the system may undergo a change by the attachment of new sources of supply, or the extension to new market areas, or the development of gas storage facilities. To hold that effectuation of a primary purpose of the Congress in the enactment of this legislation is dependent upon the fixedness of the operations of the subject company and the improbability of a change in its operations or extension of its facilities would be unreasonable.

The matter before us involves that which is frequently termed a "discrimination case" as distinguished from that which is usually called a "rate case." As so designated, the latter type of case generally involves a determination as to the reasonableness of rates in the sense of whether they are adequate and non-confiscatory or whether they are excessive and unjust. Here we are not concerned with reasonableness in this sense, but rather as to whether rates—otherwise presumed to be reasonable—are unduly discriminatory or preferential. This phase of the proceeding is founded primarily upon sub-section (b) of Section 4 of the Act which provides as follows:

> "(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service."

These prohibitions against undue preference or advantage, undue prejudice or disadvantage, and unreasonable differences in rates, charges, service, or facilities are implemented by subsection (a) of Section 5 of the Act.[8]

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[8] The fact that this proceeding was initiated under the primary authority of Section 4(e) of the Act is immaterial. This section provides, in pertinent part, that:

> "* * * after full hearings, either completed before or after the rate, charge classification, or service goes into effect, the Commis-

The Natural Gas Act does not attempt to define unlawful discrimination or preference with mathematical precision. Instead it is left to the Commission to primarily decide whether from facts, disputed or undisputed, in a given case preference or discrimination exists;[9] and whether it is of such a nature as to be unlawful within the contemplation of the statute. As the Commission has heretofore found, discrimination or preference may be exhibited in various forms.[10]

The matter now before us involves a determination as to whether unlawful discrimination or preference is created by the exaction from all customers on a transmission system of identical, uniform rates when the points of delivery to the several customers are as much as 600 miles apart. We find, under the circumstances of this case, that Northern's uniformly applicable rates and charges are unduly discriminatory as to some of its customers and unlawfully preferential as to others.

It is a simple economic fact that the delivery cost of natural gas increases in close proportion to the length of the transmission line of any given size. From this Proponents and the Staff reason that it is unreasonable, unduly discriminatory and preferential to charge customers located nearer to the source of gas supply with the same burden of transmission costs as are assessed to customers situated 100,

sion may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective." This refers, of course, to a proceeding initiated under authority of Section 5(a). Thus, the Commission is empowered to grant the relief here requested—if it is found appropriate and proper so to do. *Ayshire Collieries Corp., et al. v. United States, et al.*, 335 U. S. 573, 581-583.

[9] See *United States, et al. v. Chicago Heights Trucking Co., et al.*, 310 U. S. 344, 352-353; *United States v. Louisville & Nashville R. Co.*, 235 U. S. 314, 320.

[10] E.G., see Opinion No. 225, *In the Matters of Atlantic Seaboard Corp., et al.*, pages 29-32 (mimeo. ed.); *In the Matter of Transcontinental Gas Pipe Line Corp.*, 9 F. P. C. 32, 53-54, 63; *In the Matter of Michigan Wisconsin Pipe Line Co., et al.*, 9 F. P. C. 127, 135-136, 150; *In the Matter of San Juan Pipe Line Co., et al.*, 9 F. P. C. 170, 185, 194.

200, or even 600 miles farther from the source. The charging of uniform rates under such circumstances, it is said, saddles the customers requiring the lesser transportation with costs that are incurred solely for the benefit of customers farther removed from the source of gas—and requiring consequent longer haul. Without more, it would seem that these proponents of zoning for Northern's system have made their case.

The parties opposed to zoning contend, however, that the factor of distance of transmission is off set by the fact that sales made in Minnesota—the most remote state served by Northern—have benefited customers below Minnesota, in that such customers enjoy a lower unit transmission cost than they otherwise would have without the benefit of such sales on the system. This is but another way of stating the generality that for any given length of pipe line, with any given load factor, the larger the line the lower the unit delivery cost of gas. This results from the fact, as shown by the record here—as well as elsewhere,[11] that, while the cost increases approximately in proportion with the diameter, the capacity increases more than the area, so that the capacity of a 24-inch line, for example, is about three times that of a 16-inch line.

We, too, are inclined to the opinion that sales in Minnesota benefit the customers elsewhere on Northern's system by contributing to the large volume of gas handled on this system and the lowering of the unit cost of transmission. At the time of the hearing herein, it was estimated that jurisdictional sales in Minnesota in 1954 would total 104,574,000 Mcf, which was 44.58 per cent of the total of such sales. However, it would appear that jurisdictional sales in the other states served by Northern, estimated to aggregate 130,014,200 Mcf in 1954, would make an equal or greater contribution to the lowered cost of transmission—and to Minnesota customers.

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[11] Docket No. G-580, *Natural Gas Investigation, Smith-Wimberly Report,* page 240.

In a further effort to develop this theory and to show that customers in the areas of Northern's system are enjoying a lower cost as a result of the sales made in the farther areas, the so-called Opponents introduced in evidence a laboriously prepared study which purports to reflect the design and costs of constructing and operating a theoretical pipe-line system to serve only those customers in Nebraska, Iowa, and South Dakota. The fundamental purpose of this study, it is said, "was to prove that had any zone under consideration not been served along with the balance of the service area, its service costs would have been higher than they actually are under Northern's presently used uniform rate system." On another occasion when confronted with similar evidence the Commission said:[12]

> "For the most part the assumptions made either do not square with realities or are patently unreasonable as applied to properties and operating conditions such as those concerned."

The same thing could be said of the similar studies in this case.

In any event, it would seem that the studies prove too much. The single study offered for the record by the group of Opponents purports to show the cost benefits derived by customers outside of Minnesota because of the lowered unit transmission cost resulting from the combined jurisdictional sales in the entire system. This study purports to show that sales from the theoretical system serving only Nebraska, Iowa, and South Dakota would have cost customers in these states 1.57 cents per Mcf more in 1951 and 1.442 cents per Mcf more in 1952 than the actual average cost in these years under Northern's uniform system rates. However, it was developed on the record that the witness who prepared this study had made a similar study of a theoretical line to serve only the State of Minnesota. The latter study indicates that the Minnesota customers, if served

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[12] *In the Matter of Canadian River Gas Company, et al.*, 3 F. P. C. 32, 62; aff'd, 324 U. S. 581.

by separate facilities, would have paid 6.21 cents more per Mcf in 1951 and 5.483 cents more per Mcf in 1952 than the actual average cost in these years under Northern's uniform system rates. Thus, even under this approach of the Opponents, which we not not accept or approve, it would appear that the Minnesota customers are the prime beneficiaries under the uniform rate practice of Northern.

As a part of this consideration of the relative contributions made by different markets on the system to the cost of transmission, it is important to consider also the distribution of the load on the system. As shown hereinbefore, eight municipal areas account for slightly more than 71 per cent of the total jurisdictional sales estimated for 1954, supra, page 9. As will also be noted, the miles of transportation required to effect the deliveries at these eight points range from 448 to 803. The following tabulation gives a complete breakdown by mileage of the total jurisdictional sales.

Distance in Miles from Source of Gas Supply	Estimated Jurisdictional Sales for Year 1954 (Mcf)	Percentage of Total Jurisdictional Sales
0 - 400	1,826,400	0.778
401 - 500	47,520,800	20.257
501 - 600	20,025,500	8.537
601 - 700	61,954,900	26.410
701 - 803	103,260,600	44.018
Totals	234,588,200	100.000

It is of further significance to note that more than 50 per cent of the estimated jurisdictional sales for the year 1954 require transportation through Northern's facilities for distances of less than 650 miles. Considering the data shown in the above tabulation, as well as the more detailed evidence in the record, we find that there is no such concentration of sales in a single area of the system as would countervail against the arguments of the Proponents and the Staff that the distance of transmission—the mileage of haul—is the primary and controlling factor in the determination of the basic issue here. While it is true that 37.5 per cent of the total estimated jurisdictional sales for

1954 were made at or near the terminus of Northern's system, the distribution of the remainder of these sales along the system is such as to foreclose a finding that sales at the farthest points of the system are so predominate as to be of controlling consideration rather than the distance factor.

We take particular note, too, of the fact that the annual load factor of estimated 1954 sales in Minnesota is lower than the system average for jurisdictional sales and the lowest also of any state served by Northern. The matter of load factor is of importance because for any given length and size of transmission line, delivery cost per Mcf increases as the load factor at which the line is operated decreases.[13] Thus, as hereinbefore noted, while the large volume sales in Minnesota undoubtedly contribute to a lesser unit cost for transmission, the lower load factor of such sales has a converse tendency.

During its long administration of the Interstate Commerce Act, the Interstate Commerce Commission has often had occasion to pass upon matters similar to those here involved. While the Interstate Commerce Commission in its regulation of the railroad and motor carriers of the nation must often consider other factors which are generally foreign to the natural-gas industry, in proceedings involving haul and place relationships that Commission gives principal consideration to the factors of distance and competition between carriers. The Commission's regard of these factors in this type of proceedings has been well stated as follows:[14]

> "While there is no easy index of rate-paying ability, cost of service obtrudes itself in an obvious and inescapable form through the element of distance. The

[13] This generality simply gives expression to the mathematical fact that more complete utilization of any given capital facilities involving fixed costs will result in declining unit costs. Docket No. G-580, *Natural Gas Investigation, Smith-Wimberly Report*, page 260; *Hamilton, Cost as a Standard for Price*, 4 Law and Cont. Prob. 321, 330.

[14] Vol. III-B, *Sharfman, The Interstate Commerce Commission*, pages 541-542.

length of the haul is a physical fact which provides an objective measure of the amount of service rendered; and although cost does not vary in direct proportion to distance (any more than ability to pay varies in direct proportion to the value of commodities), even a rough application of the distance principle tends to improve the most questionable rate relationships, and reasonable refinements can readily be made where they are needed. Accordingly, the element of distance as an index of the cost and worth of transportation service appears to have commended itself to the Commission as a leading consideration for reasons of its easy ascertainment and popular appeal as a fair standard, as well as because of the more substantial economic grounds which support its recognition. Despite many evidences of the Commission's inclination to observe that cost is only one of a number of significant factors in rate-making, it does not appear that in the adjustment of charges between hauls any other criterion has been set up as a positive guide in the processes of rate control.

"Broadly regarded, then, the vast number of rate proceedings involving haul and place relationships lend themselves to a fairly uniform pattern of analysis. The principal factors to be considered have generally been distance and competition [between carriers]. The basis of complaint has commonly consisted of an apparent failure to adjust charges in sufficiently close conformity to the length of the haul or of some related cost element, the extenuating circumstances urged as justification of rate adjustments which disregard distance have commonly consisted in the exigencies of competition or of some related condition involving the need of attracting traffic. As already noted, these considerations—distance and competition—have operated on different levels; the one as a positive standard to which closer conformity may be required; the other as a plausible ground for permitting departure from this standard."

To a similar effect, we note the statements on this subject by another authority, which has been cited to us by the Opponents:[15]

> "The [Interstate Commerce] Commission has always recognized distance, however, as a most important consideration in rate making and has said that, as a general rule, other things being equal, distance should be a controlling factor, and rates between distant points should exceed those between points less distant. Distance, however, has never been regarded as the sole consideration. As said by Commissioner Prouty 'Rates cannot be made with a yard stick.' Where, therefore other circumstances are present which outweigh the importance of the length of the haul, either as affecting the cost or the value of the service, it has held that distance may properly be disregarded."

Our position in this proceeding is thus in general accord with the position taken by the Interstate Commerce Commission in similar matters which has so often been approved in the courts.

As previously stated, it is a simple economic fact that the delivery cost of natural gas increases in close proportion to the length of the transmission line of any given size. Therefore, unless other circumstances are present which outweigh the importance of the length of transmission required to effect delivery, the distance factor is the prime [illegible] of the cost of rendering service. Since in our view of this record there are no such circumstances present to counter-balance the distance factor, we conclude that the distance of transmission required to effect deliveries at the various points of sale by Northern reflects with reasonable accuracy the relative cost of providing service to its customers. We further find and conclude that Northern's present practice of demanding and collecting uniform rates throughout the length and breadth of its area of service for the sale of natural gas for resale is unjust, unreasonable,

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[15] *I. Drinker, Interstate Commerce Act* §58 (1909).

unduly discriminatory, and preferential. This practice results in the shifting of transmission cost from those whose service requires its incurrence by reason of the greater transportation distances to others who are not responsible for such cost—and who are not benefited correspondingly.

Having found and concluded that Northern's present uniform rate practice is unlawfully discriminatory and preferential, there is to be determined the manner in which the discrimination and preference may be most properly eliminated. In theory, the ideal, non-discriminatory, and non-preferential rate structure would be one designed to assess each point of sale and delivery with the total of the various cost components incurred in the rendering of service to each point. But any attempt to arrive at such perfection would be not only delusory,[16] but also impracticable and infeasible from both the management and regulatory point of view. In the circumstances of this case, the only practical and reasonable approach to an equitable solution is the establishment of service zones—with rate differentials—as urged by the Proponents of zoning and the Staff.

The Proponents of zoning recommend the establishment of two zones on Northern's system, exclusive of the so-called Argus System which is sometimes referred to as a zone. The boundary lines, under this recommendation would be established at the suction side of the Oakland (Iowa) Compressor Station on the east branch of the system and the suction side of the Hooper (Nebraska) Compressor Station on the west branch.

The staff witness presented in evidence four different possibilities of zoning for Northern's system.[17] These several suggested methods of establishing zones may be summarily described as follows:

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[16] *Colorado Interstate Gas Company v. Federal Power Commission, et al.*, 324 U. S. 581, 589; *Hamilton, Cost as a Standard of Price, supra;* Op. No. 225, *In the Matter of Atlantic Seaboard Corporation, et al.*, pp. 17-19 (mimeo. ed.).

[17] As noted hereinbefore, the Staff, as such, did not take a position on the zoning issue during the course of the hearing (Fn. 5 *supra*).

Proposal A—Boundary lines between zones 1 and 2 to be established at the Bushton (Kansas) Compressor Station. Boundary lines between zones 2 and 3 to be established at the Hooper Compressor Station on the west branch and at the Oakland Compressor Station on the east branch of the system.

Proposal B—Boundary lines between zones 1 and 2 to be established at the Kansas-Oklahoma border. Zones 2 and 3 to be separated by a line running through the Beatrice (Nebraska) Compressor Station. Zones 3 and 4 to be separated by dividing lines at the Paullina (Iowa) Compressor Station on the west branch and the Ogden (Iowa) Compressor Station on the east branch.

Proposal C—Under this plan each of the states through which Northern's system extends would constitute a separate zone as follows: Zone 1—Oklahoma, Zone 2—Kansas, Zone 3—Nebraska, Zone 4—Iowa, Zone 5—South Dakota, and Zone 6—Minnesota.

Proposal C Modified—A modification of Proposal C to establish additional sub-zones in the states of Nebraska and Iowa having boundary lines equi-distant from the source of gas supply.

The Staff, as such, recommends the so-called Proposal B, as briefly described above. In expressing his individual opinion, as distinguished from the collective opinion of the Staff, the staff witness stated the so-called Proposal C Modified to be most suitable for Northern's system.

The Presiding Examiner found and concluded that:

"(12) The most feasible method of zoning the system of Northern, as it existed prior to construction of the facilities authorized in Docket No. G-2063, would be obtained by the creation of an A or Argus Zone, extending from the southern end of Northern's system to the Bushton compressor station and a division of the remainder of the system into two zones at a point far enough north of the Ogden, Iowa, and Paullina, Nebraska, compressor stations to fix (with-

out question) in the southernmost of said zones the delivery points from the main line to the Waterloo-Dubuque and Boone-Marshalltown laterals connected to the Ogden station and the Sioux Falls lateral connected to the Paullina station."

Both the Proponents and the Staff have taken exception to this finding of the Examiner, each urging approval of the particular zoning proposal recommended by them.

After detailed consideration of the record, we have concluded that none of the zoning plans presented by the Proponents and the Staff or the modified plan which the Examiner finds most feasible are appropriate and acceptable. While each might as claimed tend to eliminate or reduce the discriminations and preferences existing under the present rates of Northern, the facts are clear that other inequities would be created by the establishment of zones according to any of these plans.

Under each of these plans, including that found most proper by the Decision, determination of the zone in which a particular sale is made would be fixed by the point on the main line from which the lateral line enabling such sale takes off. All of Northern's sales of gas for resale are effected at the city gates of the communities served. In most instances these sales are made at the terminii of lateral lines branching from the main line transmission facilities. Thus, the total distance of transmission to each point of delivery is represented by the aggregate of the mileage of transmission through both the main line and the lateral line serving each point of sale. As a result, as is elaborately pointed out by the Opponents, under each of these methods of zoning the total mileage of transmission to certain points in zones closer to the source of supply is greater than the mileage to other points of sale in zones farther removed from the source. Under each of the plans considered, including the Examiner's, deliveries to certain points requiring the greater mileage of transmission would be made at the lesser rate.

The foregoing is sufficient in our view to condemn each of these methods of zoning. Therefore, it would serve no useful purpose to relate in exhaustive detail other infirmities which we find, but brief additional comment would be illustrative. The zoning proposed by the Proponents would result in a wholly disproportionate division of the principal market territory. Under this plan Zone 1 sales would represent only about 22 per cent of the total jurisdictional business, whereas approximately 78 per cent of these sales would be included in Zone 2. Moreover, under this plan, Zone 1 sales would assume a relatively small and disproportionate portion of the costs associated with the hundreds of miles of lateral lines on the system. These same points of criticisms are also appropriate for the Staff's so-called Proposal A, which is substantially similar to the plan of the Proponents excepting that an additional zone is proposed south of the Bushton station.

The establishing of a separate zone for each state, as contemplated in the Staff's Proposal C, is a method which has been employed by other natural-gas companies. However, it is wholly inappropriate and would be inequitable on Northern's system, particularly because of the geographical relationship of the facilities to the boundary between the States of Nebraska and Iowa. Staff's Proposal C Modified is also unsatisfactory, not only for reasons hereinbefore stated, but also because it would provide for the establishment of too many zones on this system, particularly in the principal market area which is about 400 miles in length and about 300 miles between the westernmost and the easternmost points of sales. We believe that zones should include as large an area of service as may be consistent with equitable treatment to all customers. Furthermore, this plan more than any other suggested would be responsive to any change of markets or facilities so as to necessitate possibly the establishment of other zones or sub-zones.

Considering the foregoing, and all other facts of record, it is our opinion that the most appropriate and practicable method would be the establishment of three zones on Northern's system with zone boundaries as depicted on the map

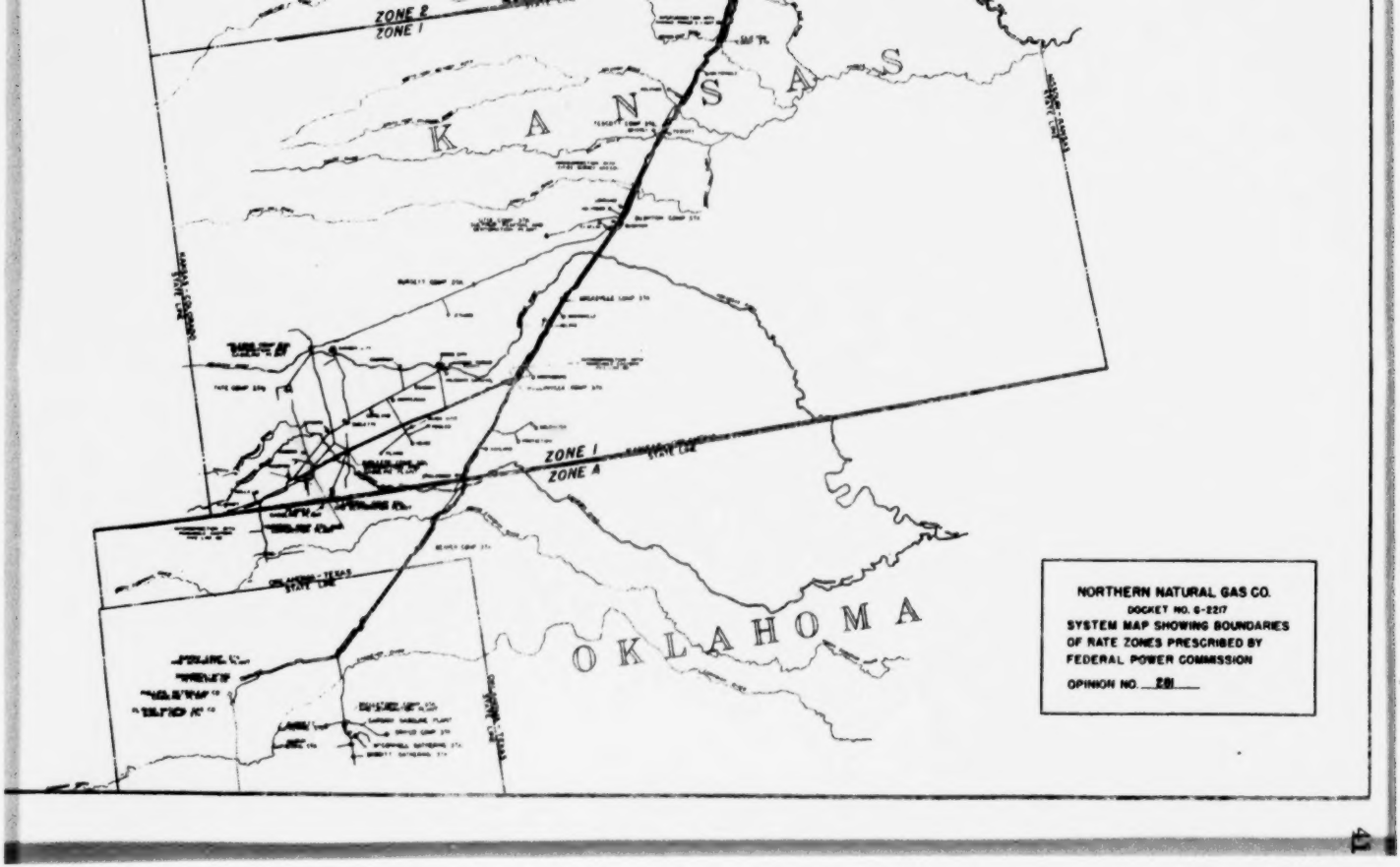
following this page.[18] (Illustration in this instance is more desirable—and more effective—than description.) This plan, in our view, provides the most effective and equitable basis for eliminating the present unlawful discrimination and preference.

As noted previously, the Bushton Compressor Station is the last point of input of gas into the main-line facilities. Under this plan, the service area north of the Bushton station, wherein more than 99 per cent of the jurisdictional sales are made, is divided into three zones which are as nearly equal as they can reasonably be so far as transmission distances are involved. Zone 1 embraces all sales requiring transmission to the point of delivery, including that made through lateral lines, for a distance of 191.0 miles beyond the Bushton station. Sales made at points south of the Bushton station, including sales in the so-called Argus System, also fall within Zone 1. All sales made on the west leg of the system requiring transmission up to a distance of 190.43 miles beyond the Zone 1 northern bound-

[18] These three zones encompass the whole of Northern's system north of the Oklahoma-Kansas boundary, which is the area in which all of its sales are made. It would seem appropriate also to designate the area south of the Oklahoma-Kansas line where Northern has facilities as "Zone A".

SOUTH DAKOTA
NEBRASKA
IOWA
ZONE 3
ZONE 2
ZONE 3
ZONE 2

SOUTH DAKOTA
NEBRASKA
IOWA
ZONE 3
ZONE 2
ZONE 3
ZONE 2
ZONE 3
ZONE 2
ZONE 2
ZONE 1


ZONE 2
ZONE 1
K A N S A S
ZONE 1
ZONE A
O K L A H O M A
NORTHERN NATURAL GAS CO.
DOCKET NO. G-2217
SYSTEM MAP SHOWING BOUNDARIES
OF RATE ZONES PRESCRIBED BY
FEDERAL POWER COMMISSION
OPINION NO. 281

ary and all sales made on the east leg of the system requiring transmission up to a distance of 190.15 miles beyond the Zone 1 boundary fall within Zone 2. Sales falling in Zone 3 require transmission for a maximum distance of 180.8 miles on the west leg and 183.0 miles on the east leg beyond the northern boundary of Zone 2. As estimated for the year 1954, jurisdictional sales in Zone 1 would amount to 2,508,100 Mcf, or 1.07 per cent of the total of such sales, 103,620,800 Mcf or 44.17 per cent in Zone 2, and 128,459,300 Mcf or 54.76 per cent in Zone 3.

Under the procedures advocated by the Proponents of zoning for distributing the cost of service to the zones recommended by them, all costs except transmission costs were allocated on a system-wide basis in the manner prescribed by the Commission in its Opinion No. 228, issued in an earlier proceeding involving increased rates of Northern, and used also in arriving at the settlement of other issues in this instant proceeding as heretofore mentioned. Costs associated with the operation of the transmission main line facilities in Proponents proposed Zone 1 were likewise allocated by them to all customers, excepting those in the Argus System, on a system-wide basis, on the theory that these facilities are used for serving all customers. Costs associated with the branch or lateral lines located in that Zone 1 were assigned solely to the Zone 1 customers. Similarly, all costs associated with transmission plant located in their proposed Zone 2 were assigned by the Proponents solely to that zone, as they are not considered to be used in any way to provide service to Zone 1.

The Staff in distributing the total cost of service to the several zones, first determined the average weighted transmission miles required to haul purchased and produced gas, as estimated for the year 1954, from the various sources to a common point on the system, which was determined to be the Bushton Compressor Station, the last point of input. The number of transmission miles from the source of supply to each sales delivery point was then determined. Transmission demand miles were computed by multiplying the mileage thus obtained for each delivery

point by the three-day system peak average sales at each such point. Transmission commodity miles were computed by the multiplying of the mileage to each delivery point by the annual sales made at that point. The data thus obtained was then grouped by zones and by classes of service.

Under the Staff's procedure the unit cost of service on a system-wide basis was then determined for each function and allocated to zones and classes of service as follows: Production costs were allocated to all sales in proportion to the volume of annual sales; transmission costs were allocated by the computed demand and commodity Mcf-miles; distribution and customers' accounting and collecting costs were assigned to zones according to the number of sales delivery points; and sales promotion expense was allocated to zones in accordance with estimated annual volume of sales. Drilling and pumping sales were assigned transmission costs by Mcf-miles based upon the average distance of groups of such sales from the supply source.

We do not believe it either sound or reasonable to allocate costs in part on a system-wide basis and in part on the basis of a segregation of certain properties as the Proponents have done. For the purposes of this case wherein we are attempting to arrive at a sound and equitable basis for establishing for the first time a differential in rates in separated areas of a system which has not heretofore had zone rates, we find the theory of the cost allocation procedure advocated by the Staff to be particularly appropriate. We further find, however, for the reasons stated below that certain modifications should be made to the precise manner in which it was applied by the Staff in this case.

The previously mentioned statement of settlement in this proceeding, which was approved by our order issued January 28, 1954, provided, among other things, as follows:

"SECTION VII

"Further Proceedings

"It is agreed that this settlement will dispose of all matters involved and issues presented in this proceed-

ing, excepting the single issue respecting zones of service and differentials in rates between zones. It is further agreed that further hearings herein respecting such issue shall be had at the earliest practicable date and the cost of service hereinbefore set forth and agreed upon for the purposes of this settlement shall be used to the extent that cost of service is involved.

"For the purposes of this settlement it is further agreed that the decision of the Commission respecting such issue of service zones and rates differentials, if it requires a change in the revised rate schedules filed pursuant to Section 1 hereof, shall not be made effective prior to December 27, 1954, nor result in revenues less than the agreed cost of service. It is also agreed that, if so required by decision of the Commission on further hearings herein, Northern shall incorporate in revised rate schedules filed to become effective on or after December 27, 1954, the methods and principles found by the Commission, subject to judicial review, to be proper as to zones and rate differentials, with due regard to the recovery of reasonable cost of service."

The total cost of service for the year 1954 agreed upon for the purpose of such settlement was $88,584,957, of which, it was further agreed, $73,083,254 was allocable to jurisdictional sales. There was also agreement in this settlement as to the allocation of such costs to the functions of production, transmission, distribution, customers accounting and collecting and sales promotion.

In the preparation and presentation of evidence in the hearing in this matter, the Staff, of course, was bound by these provisions of the stipulation. Accordingly, in the allocation of costs to the several proposed zones the Staff used the costs as allocated to functions for the purpose of the settlement.

In the allocation so made for the purpose of the settlement the transmission costs of Permian Basin Pipeline Company, Northern's subsidiary and a supplier, were added

to the transmission costs of Northern, although the delivery of gas by Permian is made at the southern terminus of Northern's own system. While such an allocation was proper for the purpose of establishing rates on a system-wide basis, the transmission costs of Permian should not here be spread on a mileage basis but rather should be included with other production and supply costs and spread on the basis of sustained peak demand and annual sales. In the settlement allocation a part of the administrative and general expense was also assigned to the transmission function as were costs of transmission and compression of gas by others before entry into the transmission system facilities. Since these costs are not specifically related to the miles of gas transportation, they too should properly be distributed on the basis of sustained peak demand and annual sales.

We also find that the Staff's allocation of distribution and customers' accounting and collecting costs on the basis of sales delivery points produces wholly disproportionate results. Under this procedure the same amount of expense is attributed to the point of smallest volume of sales and requiring the smallest of metering and regulating equipment as is attributed to the largest of customers whose purchases require the most expensive metering and regulating equipment. Since the record does not provide a breakdown of these costs sufficient to determine the actual cost at each point of delivery, we find that it would be proper for the present purpose to distribute one-half of these costs according to the number of delivery points and one-half in the proportion of the volume of sales. In this manner, recognition would be given in part at least to the comparative size of the various markets served and to the varying costs related thereto. As so modified, we will utilize hereinafter the allocation procedure of the Staff.

As so modified we believe the cost allocation procedure proposed by the Staff to be most suitable for the purpose of this case, and we adopt it for this purpose.

Subsequent to the close of the hearing on the phase of the proceeding here under consideration, Northern, on July

2, 1954, filed revised uniformly applicable rate schedules designed to provide an increase in revenues from jurisdictional sales of $8,128,405, or 10.4 per cent, annually over and above the revenues estimated to be produced by the rates allowed to become effective pursuant to the settlement and our order herein issued January 28, 1954. The proposed increase in rates was based on sales for the year ended March 31, 1954, as adjusted. In support of this increase, Northern relies principally on claimed costs of new plant facilities, the majority of which were not then estimated to go into service until September and October, 1954. The total cost of service claimed by Northern in this filing is $103,533,908, as contrasted to the amount of $88,584,957 stipulated as the cost of service to be used for the purpose of the hearing in this instant proceeding.

By order issued July 29, 1954, at Docket No. G-2505, we suspended and deferred the use until December 27, 1954, of the increased schedules filed July 2, 1954. Thereafter, pursuant to proper motion of Northern, the suspended schedules were allowed to become effective as of December 27, 1954, subject, however, to the condition, among others, that Northern shall refund, with interest, the portion of such increased rates or charges as the Commission may by its decision in that proceeding find not justified. Since the proceedings have not been concluded and a decision has not been made in the matter at Docket No. G-2505, the increased rates are now being collected, subject to possible refund of a portion thereof.

Considering the lapse of time occasioned by necessary procedures in this case and the facts recited above, it would be inappropriate and improper to now require by order in this proceeding that Northern file substitute revised tariff sheets to be made effective as of a retroactive date or based upon a cost of service less than that claimed by Northern in its previously mentioned filing of July 2, 1954.

Of the total cost of service claimed in support of the filing of July 2, 1954, Northern has allocated $86,538,101 to the jurisdictional sales. However, the procedures used by Northern in making such allocation are unlike those

prescribed by the Commission in its Opinion No. 228 in earlier proceedings concerning Northern's rates, which were followed also in the settlement of the other aspects of this instant matter.

Using the claimed jurisdictional cost of service of $86,538,101, but applying thereto the principles and methods of cost classification and allocation hereinbefore found to be proper, we obtain the following results:

	Rate Schedule CD-1			Average Cost Per Mcf		
	Demand Charge	Commodity Charge	Over-run Commodity Charge	70 Per Cent Load Factor	80 Per Cent Load Factor	100 Per Cent Load Factor
Zone 1	$0.94	22.93c	22.93c	27.41c	26.85c	26.06c
Zone 2	$2.00	23.80c	23.80c	33.32c	32.13c	30.47c
Zone 3	$2.08	26.48c	26.48c	36.38c	35.14c	33.41c

The estimated volumes of sales for resale shown in the new rate filing of Northern reflect an annual load factor for this class of sales of about 70 per cent. At this load factor, it will be noted, the differential in average cost to the purchasers in Zones 2 and 3 is shown in the tabulation to be 3.06 cents per Mcf. Considering, however, that this differential is calculated on the basis of the total cost claimed by Northern which in certain respects at least is not in accord with prior decisions of the Commission in proceedings involving rates of Northern, and the fact that past experience indicates the possibility that Northern may not be able to fully support its claimed cost of service, we are of the opinion that the maximum differential in rates to be made effective at this time on an interim basis, subject to subsequent adjustment and possible refund, should be about 2.00 cents per Mcf. This differential is the difference in average cost per Mcf purchased at a load factor of 70 per cent. The following tabulation reflects a recasting of the rates shown in the previous tabulation to produce a differential between Zones 2 and 3 of 2.04 cents per Mcf, which is as close as can be computed:

	Rate Schedule CD-1			Average Cost Per Mcf		
	Demand Charge	Commodity Charge	Over-run Commodity Charge	70 Per Cent Load Factor	80 Per Cent Load Factor	100 Per Cent Load Factor
Zone 1	$1.75	23.5c	23.5c	31.83c	30.79c	29.33c
Zone 2	$2.00	24.3c	24.3c	33.82c	32.63c	30.97c
Zone 3	$2.07	26.0c	26.0c	35.86c	34.63c	32.90c

As previously noted, the parties opposed to zoning, including Northern, contend that an increase in rates will result in the loss of industrial sales to competitive fuels by some of Northern's customers. In deference to this position, Northern, in its rate filing of July 2, 1954, proposed no increase in the commodity component of its rate and instead increased only the demand component.[19] Furthermore, by such filing, Northern proposed the elimination of the differential of 2 cents per Mcf heretofore added to the commodity component to arrive at the rate for the purchase of "over-run gas", being volumes in excess of the contracted demand.[19] We find the evidence on this point of contention something less than convincing. No evidence whatsoever in this respect was offered by Northern States Power Company, an intervener herein and an active opponent of zoning, which is undoubtedly the largest consumer of industrial gas supplied by the Northern system and certainly well provided with information and data as to the costs of purchasing and handling other competitive fuel. However, the proceedings at Docket No. G-2505 will provide a further opportunity to develop evidence on this point. Furthermore, experience under zone rates pending disposition of those proceedings will give further indication of the probable future trend of industrial sales of natural gas in the area served by Northern. All of which can be given consideration in the decision in the proceedings at said Docket No. G-2505, including the fixing of the level of rates in each zone. Accordingly, at this time we will permit Northern, if it chooses so to do, to maintain in the rate schedules filed

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[19] In explanation, Northern states in its rate filing of July 2, 1954 that:

"In order that a favorable competitive position be maintained for large volume loads, it is the judgment of Northern's management that the commodity charge under Rate Schedule CD-1 should not be increased at this time. Accordingly, the commodity charge has been retained at the present level of 22.1c per Mcf and the demand charge increased from $2.21 to $2.70 per Mcf of billing demand in order to recover cost of service.* * *

"The same considerations have led Northern's management to propose that the overrun price of 24.1c per Mcf in the presently effective R-1 Rate Schedule be reduced to 22.1c per Mcf, the same as the commodity charge under Rate Schedule CD-1."

pursuant to the order in this instant matter a uniform commodity charge throughout its system, and to adjust the demand component of the rates to provide a differential between zones of approximately 2.00 cents per Mcf at a 70 per cent load factor as indicated in the tabulation last above.

As their final point of argument, the parties designated as the Opponents appear to suggest, although they do not so state, that the proviso of Section 5(a) of the Natural Gas Act precludes the Commission from requiring Northern by order to establish service zones and rate differentials. This proviso, however, does not preclude the Commission from granting the relief sought in this proceeding.[20] To hold otherwise would do violence to the purpose and object of the legislation.

Undue discrimination or preference, as found to exist by reason of the present rate practice of Northern, may be eliminated in several ways, of which an increase in rates for certain service is only one. Section 5(a) specifically provides also that "the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates." It would also be quite proper for the Commission, upon the finding of undue discrimination or preference under the facts of this case, to determine appropriate zones of service and require Northern to file appropriate rates which would not be unduly discriminatory or preferential.[21] And the Commission may, as we do here, in the circumstances of a particular case merely determine and fix the differential in rates that is reasonable and necessary to

[20] In *Michigan Consolidated Gas Company v. Panhandle Eastern Pipe Line*, 173 F. 2d 784, 789, the Court of Appeals said:

> "Whatever may be the limits placed by the [Natural Gas] Act upon the authority of the Commission in other respects, it is clear that under §717c(b) [Sec. 4(b)] the authority of the Commission, in respect to undue preferences or advantages is without limitation."

[21] *Federal Power Commission et al. v. Natural Gas Pipeline Company, et al.*, 315 U. S. 575, 583-585.

eliminate existing unlawful discrimination and preference, leaving to the company the decision as to how such differential shall be incorporated into its rate schedules. As the Supreme Court has said:[22]

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."

The Commission further finds, for the reasons given and upon the findings hereinbefore set forth:

(1) Northern Natural Gas Company, a corporation organized and existing under the laws of the State of Delaware, is engaged in the transportation of natural gas in interstate commerce and in the sale in interstate commerce of such gas for resale, and, is, therefore, a "natural-gas company" within the meaning of the Natural Gas Act.

(2) The demanding, charging, and collecting by Northern of uniform rates and charges for all sales of natural gas by it, subject to the jurisdiction of the Commission, is unduly discriminatory and preferential, and therefore, unlawful.

(3) The establishment of zones of service with proper differentials in the rates and charges applicable to sales in the respective zones, subject to the jurisdiction of the Commission, would be the most effective and equitable means of fixing rates and charges which would be not unduly discriminatory or preferential.

(4) Northern should be required to file appropriate revisions to its FPC Gas Tariff to provide for the division of its system into three rate zones bounded in the manner and at the locations specifically shown

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[22] Idem, page 586.

on the map following page 26 hereof, as hereinafter ordered and conditioned.

(5) The statement of settlement of the issues in this proceeding other than those respecting service zones and rate differentials, which was agreed to by Northern and all other parties and approved by the Commission, provides, among other things, that:

"SECTION VII

* * * * *

"For the purposes of this settlement it is further agreed that the decision of the Commission respecting such issue of service zones and rate differentials, if it requires a change in the revised rate schedules * * *, shall not be made effective prior to December 27, 1954, nor result in revenues less than the agreed cost of service. It is also agreed that, if so required by decision of the Commission on further hearings herein, Northern shall incorporate in revised rate schedules to become effective on or after December 27, 1954, the methods and principles found by the Commission, subject to judicial review, to be proper as to zones and rate differentials, with due regard to the recovery of reasonable cost of service."

(6) The adjusted total cost of service agreed upon in the above-mentioned approved settlement was $88,584,957 for the twelve-months' period ending December 27, 1954, the test period, of which amount, it was further agreed, $73,083,254 was properly allocable to jurisdictional sales.

(7) On July 2, 1954, Northern filed certain revised sheets to its FPC Gas Tariff proposing an increase in rates and charges of $8,128,405 annually over and above the rates and charges allowed to become effective as of December 27, 1953, pursuant to said approved settlement. These proposed increases were based upon estimated sales for the year ended March 31, 1954, as adjusted, and a claimed over-all cost of service for that period of $103,533,908. Of

this total Northern has allocated $86,538,101 to the jurisdictional sales.

(8) By order issued July 29, 1954, at Docket No. G-2505, the Commission suspended and deferred the use until December 27, 1954, of the said revised sheets filed on July 2, 1954. Thereafter, by order issued January 7, 1955, upon proper motion of Northern, said revised sheets and increased rates and charges were allowed to take effect as of December 27, 1954, subject to such refunds as might be thereafter ordered by the Commission.

(9) In view of the facts set forth in paragraphs (6), (7), and (8) hereinbefore, it would be inappropriate to now require by order in this proceeding that Northern file substitute revised tariff sheets to be made effective as of a retroactive date or based upon a total cost of service less than that claimed by Northern in its previously mentioned filing of July 2, 1954.

(10) Northern should be required to file with the Commission revised sheets to its FPC Gas Tariff, satisfactory to the Commission, containing schedules of rates and charges which would produce from sales for resale in the herein defined Zone 1 an average revenue approximately 2.00 cents per Mcf less than the average revenue from similar sales in Zone 2, and an average revenue from sales for resale in Zone 2 approximately 2.00 cents per Mcf less than the average revenue from similar sales in Zone 3, but said differentials in average revenues shall be not less than 1.95 cents per Mcf: Provided, however, that the design of said schedules of rates and charges shall be based on the billing determinants for sales for resale as estimated by Northern for the purpose of its aforementioned filing of July 2, 1954, and the required differentials in average revenue should be as computed at sales equivalent to use each month of contract demand at a 70 per cent load factor: And, provided further, that the design of said schedules of rates and charges shall be based upon a cost of service for jurisdictional sales not to exceed $86,538,101.

(11) The revised tariff sheets to be filed as contemplated by paragraphs (4) and (10) hereinbefore should be made effective as of May 27, 1955, for all sales of gas by Northern for resale, subject to such refunds as may be hereafter ordered by the Commission in the aforesaid proceedings at Docket No. G-2505; and said revised tariff sheets as of that date should be substituted for First Revised Sheets 5, 6, and 9 to Northern's FPC Gas Tariff, Original Volume No. 1, which became effective as of December 27, 1954, subject to such refunds as may be hereafter ordered by the Commission.

The Commission orders:

(A) Northern, within fifteen (15) days from the date of issuance hereof, shall file with the Commission revisions to its FPC Gas Tariff, satisfactory to the Commission, to provide for the division of its natural-gas transmission system into three zones bounded in the manner and at the locations specifically shown on the map following page 26 hereof.

(B) Northern, within fifteen (15) days from the date of issuance hereof, shall file with the Commission revised sheets to its FPC Gas Tariff, satisfactory to the Commission, containing schedules of rates and charges which would produce from sales of gas for resale in the heretofore prescribed Zone 1 an average revenue approximately 2.00 cents per Mcf less than the average revenue from similar sales in Zone 2, and an average revenue from sales for resale in Zone 2 approximately 2.00 cents per Mcf less than the average revenue from similar sales in Zone 3: Provided, however, that said differentials in average revenue shall be not less than 1.95 cents per Mcf. The design of said schedules of rates and charges shall be based on the billing determinants for sales for resale as estimated by Northern for the purpose of its aforementioned filing of July 2, 1954, and the required differentials in average revenue shall be as computed at sales equivalent to use each month of contract demand at a 70 per cent load factor.

(C) The schedules of rates and charges in the revised tariff sheets to Northern's FPC Gas Tariff to be filed pursuant to paragraph (B) above shall be designed so as to produce to Northern total revenues from sales of natural gas, subject to the jurisdiction of the Commission, not to exceed $86,538,101, based upon sales for the year ended March 31, 1954, as adjusted, as estimated by Northern for the purpose of the aforesaid filing of July 2, 1954.

(D) The revised tariff sheets filed pursuant to paragraphs (A), (B), and (C) above shall be effective as to all sales of gas, subject to the jurisdiction of the Commission, made on and after May 27, 1955, subject to such refunds as may be hereafter ordered by the Commission in the aforesaid proceedings at Docket No. G-2505.

(E) The revised tariff sheets filed pursuant to paragraphs (A), (B), and (C) above shall be substituted as of May 27, 1955, for First Revised Sheets 5, 6, and 9 to Northern's FPC Gas Tariff, Original Volume No. 1, which became effective as of December 27, 1954, subject to such refunds as may be hereafter ordered by the Commission in the aforesaid proceedings at Docket No. G-2505.

By the Commission. Commissioners Draper and Smith dissenting in part.

Leon M. Fuquay,
Secretary.

Adopted: May 19, 1955

Issued: May 20, 1955

In the Matter of Northern Natural Gas Company
Docket No. G-2217

DRAPER and SMITH, Commissioners, dissenting in part:

We concur fully in the conclusion of the Commission that Northern's uniform, system-wide rate structure results in undue discrimination. This, we agree, should be removed by the creation of the rate zones provided for herein and

the establishment of rates which will reasonably reflect the relative costs of service within each zone.

According to the allocation method adopted in this case, the differential in average costs between Zone 2 and Zone 3 is 3.06 cents per Mcf, based on Northern's most recent estimate of sales for resale at an annual load factor of 70 per cent. We do not hold that allocated costs should be followed slavishly in designing rates. We recognize, furthermore, that, when departures from historical rate patterns are to be made, some softening of the impact may be appropriate. We are not convinced by the evidence in this record, however, that there is reason for the majority's reduction of the indicated differential between Zones 2 and 3 from 3 cents per Mcf to 2 cents.

In our view it would be more equitable to establish an initial differential of 2½ cents. This would be subject to further consideration and adjustment in Docket No. G-2505 should the evidence therein show that such differential should be modified.

Claude L. Draper, Commissioner
Nelson Lee Smith, Commissioner

Filed: May 19, 1955
Issued: May 20, 1955

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 15,412.

Interstate Power Company,
Northern States Power Company,
Western States Utilities Company,
Minnesota Valley Natural Gas Company,
North Central Public Service Company,
Kansas City Power and Light Company
(Peoples Gas and Electric Division),
Minneapolis Gas Company,
State of Minnesota,
City of St. Paul, Minnesota, and
City of Minneapolis, Minnesota,
Petitioners,

vs.

Federal Power Commission,
Respondent.

No. 15,424.

Northern Natural Gas Company, a Corporation,
Petitioner,

vs.

Federal Power Commission,
Respondent.

Petitions to Review, Set Aside and Reverse an Order
of the Federal Power Commission.

[July 9, 1956]

Before Sanborn, Woodrough and Johnsen, Circuit Judges.

Woodrough, Circuit Judge.

Northern Natural Gas Company, seven of its customers located in the northern part of its service area, the State of Minnesota, and its Twin Cities, St. Paul and Minneapolis, are petitioners in these consolidated cases and they seek review under Section 19(b) of the Natural Gas Act, 52 St. 821, 831, 15 U.S.C., Section 717, 717r(b), of the Federal Power Commission's Order accompanying and based upon its Opinion No. 281 in Docket G-2217, issued May 20, 1955, finding the collection of uniform rates and charges by Northern Natural Gas Company, a natural gas company under the Natural Gas Act, to be unjust, unreasonable, unduly discriminatory and preferential, and ordering Northern to file revisions of its F.P.C. Gas Tariff.

The proceedings before the Commission followed upon Northern's filing revised tariff sheets with the Commission on June 6, 1953, providing for increases in its rates uniformly charged to all of its resale customers except in the Argus system. The Commission commenced a hearing and temporarily suspended such increase tariff sheets by Order dated July 24, 1953. Numerous customers of Northern were permitted to intervene in the proceedings and two of these customers, Council Bluffs Gas Company and Central Electric and Gas Company, complained in their petitions that, as they were located closer to the supply of natural gas, Northern's system of charging uniform rates was unduly discriminatory as to them and that it was unduly preferential to others farther removed from the source, and they requested that the Commission establish service zones and differentials in rates in divisions of Northern's service area to eliminate the discrimination and preference.

Hearings were begun before a Trial Examiner, but on January 21, 1953, agreement was reached by all parties to the proceedings with respect to the increases in rates and charges to be made immediately effective on Northern's system. The issue however as to establishing service zones and differentials in rates in different zones as requested by the said customers was not agreed to but was deferred by stipulation for later hearing and determination. The stipulation included the following:

"It is agreed that this settlement will dispose of all matters involved and issues presented in this proceeding, excepting the single issue respecting zones of service and differentials in rates between zones. It is further agreed that further hearings herein respecting such issue shall be had at the earliest practicable date and the cost of service hereinbefore set forth and agreed upon for the purposes of this settlement shall be used to the extent that cost of service is involved.

"For the purposes of this settlement it is further agreed that the decision of the Commission respecting such issue of service zones and rate differentials, if it requires a change in the revised rate schedules filed pursuant to Section 1 hereof, shall not be made effective prior to December 27, 1954, nor result in revenues less than the agreed cost of service. It is also agreed that, if so required by decision of the Commission on further hearings herein, Northern shall incorporate in revised rate schedules filed to become effective on or after December 27, 1954, the methods and principles found by the Commission, subject to the judicial review, to be proper as to zone and rate differentials with due regard to the recovery of reasonable cost of service."

On January 28, 1954, the Commission issued an Order approving the stipulation and requiring Northern to file tariff revisions in accordance with it. The Order also provided that "the record in this proceeding shall remain open for further hearings to be held commencing March 22, 1954, * * * respecting the single remaining issue concerning service zones and differentials in rates in areas served by Northern."

Northern filed the required tariff revisions and the hearing in respect to zoning and differentials in rates was in due course convened before the Presiding Examiner. Northern's three customers, Central Electric and Gas Company, Council Bluffs Gas Company and Metropolitan Utilities District of Omaha, located in the intermediate area of Northern's service, called witnesses, introduced evidence and argued as Proponents of zoning and rate differentials,

and all of the other intervenors participating in the proceeding and Northern joined in presenting evidence and argument in opposition thereto.

The Presiding Examiner issued decision on November 18, 1954, after extended hearings and submission of briefs, finding that Northern's existing uniform rate was not unduly discriminatory or preferential, and that the "public interest does not now require establishment of service zones or zone rates."

Exceptions were filed to the Decision by the three proponent companies and by counsel for the Commission's staff to which Northern and other opponents of zoning answered, and the Commission, sitting en banc, heard oral argument on the exceptions and answers.

On May 20, 1955, the Commission issued Opinion No. 281 and accompanying Order by which it found that the use of system wide rates by Northern is unduly discriminatory and preferential and directed Northern to divide its system into three zones with a different rate for each zone.

Northern's pipe-line transmission system is about 800 miles in length, extending from the Panhandle Field in Texas and the Hugoton Field in Kansas and Oklahoma to a point near the Twin Cities of St. Paul and Minneapolis and is, at its maximum, approximately 300 miles in width. In addition to the gas purchased from producers in these fields, Northern also takes delivery of substantial volumes of gas near Wasson, Texas, from Permian Basin Pipeline Company, a [redacted] subsidiary of Northern. Permian in turn purchases natural gas in the Permian Basin area in west Texas and eastern New Mexico, some 400 miles south of the other gas fields supplying Northern. Thus Northern's system is, in that aspect, extended to a distance of about 1,200 miles.

Natural gas transported through this system is sold to other utilities at points in Kansas, Nebraska, Iowa, South Dakota, and Minnesota for resale to consumers in these states. Deliveries to these distribution company customers of Northern are effected at many widely scattered points

requiring the transmission of the gas through Northern's system for varying distances ranging from 179 miles to 803 miles from the source of gas supply.

Northern serves one distributing company in the State of Kansas, the Kansas Power and Light Company. Deliveries to this customer are made at 15 separate points requiring transmission through Northern's facilities of distances ranging from 179 to 322 miles from the source of gas supply. Northern serves 26 other utilities in the States of Nebraska, Iowa, South Dakota, and Minnesota. Sales to these customers for resale are made at 126 points on Northern's system ranging from 390 to 803 miles along the system.

Zone 1, as prescribed by the Commission, embraces all sales requiring transmission of gas for a distance of 191 miles beyond Bushton, Kansas, and also includes all sales made south of Bushton. Zone 2 embraces all sales made on the east and west legs of Northern's main transmission line up to approximately 190 miles beyond Zone 1. Zone 3 includes all sales requiring transmission of approximately 180 miles on the west, and 183 miles on the east legs of the main transmission line beyond the northern boundary of Zone 2.

The Commission ordered Northern to file revised rate schedules to be effective as of June 27, 1955, (originally May 27, 1955) providing for a two cents per Mcf differential in average revenue for sales in each zone with the lowest rate in Zone 1 and the highest in Zone 3. This was stated to be "only an interim rate subject to subsequent adjustment and possible refund."

The Commission was unanimous:

1. In finding that Northern's uniform rates were unduly discriminatory;

2. In finding that the establishment of zones with proper differentials in the rates was necessary to eliminate this discrimination;

3. In establishing the three zones and fixing their boundaries;

4. In finding the differential in average cost of service between zones 2 and 3 to be 3.06 per Mcf.

The majority opinion concluded that a differential in rates between zones of only 2 cents per Mcf should be made effective "at this time on an interim basis, subject to subsequent adjustment and possible refund." Two of the Commissioners dissented from the Opinion on the ground that the indicated cost differential was shown to be 3.06 cents per Mcf from zone to zone and that an initial rate differential of 2½ cents per Mcf "would be more equitable," even if it be recognized that "some softening of the impact may be appropriate."

Applications for rehearing were filed with the Commission by Northern and by those customers who are the petitioners here in No. 15,412 and were denied, and the filing of the instant petitions for review in this Court followed. Meanwhile, Northern, as required by the Commission's Order accompanying Opinion No. 281, has filed revised rate schedules to reflect the service zones and zone rate differentials. This Court has subsequently accorded a partial stay of the Order.

Section 4(b) of the Act, 15 U.S.C.A. 717c(b), prohibits any natural gas company from making or granting any undue preference or advantage to any person, or subjecting any person to any undue prejudice or disadvantage with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, and Section 5(a), 15 U.S.C.A. 717d(a), empowers and requires the Commission to determine the just and reasonable rate, charge or practice to be observed by a natural gas company and to fix the same by order.

Section 5(a) also contains a Proviso "That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission unless such increase is in accordance with a new schedule filed by such natural gas company."

The opponents of zoning contended before the Trial Examiner and before the Commission, and now insist here, that the Proviso of 5(a) deprives the Commission of power to cause Northern to charge any higher rate in any zone it might set up than was shown for the same area in the currently effective schedule for the same area. They take the position that the establishment of zones and differentials in rates involved an increasing of rates in zone 3 beyond the rate for the same area contained in the currently effective schedule of the natural gas company; and that the Commission was accordingly without jurisdiction and there should be dismissal for want of jurisdiction.[1]

The Commission in reply to this contention pointed in its Opinion to the positive duty imposed upon it by the statute to determine just and reasonable rate charges and practices and to prevent any undue discrimination with respect to the sale of natural gas, and it observed:

"Undue discrimination or preference, as found to exist by reason of the present rate practice of Northern, may be eliminated in several ways, of which an increase in rates for certain service is only one. Section 5(a) specifically provides also that 'the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, or otherwise unlawful, or are not the lowest reasonable rates.' It would also be quite proper for the Commission, upon the finding of undue discrimination or preference under the facts of this case, to determine appropriate zones of service and require Northern to file appropriate rates which would not be unduly discriminatory or preferential. [*Federal Power Commission, et al. v. Natural Gas Pipeline Company, et al.*, 315 U.S. 575, 583-585] And the Commission may, as we do here, in the circumstances of a particular case merely determine and fix the differential in rates that is reasonable and necessary to eliminate existing

[1] Appended to Joint Reply brief of nine petitioners is copy of excerpts from brief filed in *Matter of Atlantic Seaboard Corporation*, Docket Nos. G-1384 and G-1175 (pp. 3-11), giving legislative history and judicial discussions of Proviso 5(a). Also excerpts from brief in same matter by Lynchburg Gas Transmission Corporation.

unlawful discrimination and preference, leaving to the company the decision as to how such differential shall be incorporated into its rate schedules. As the Supreme Court has said [Id. p. 586]:

" 'The constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.' "

The record herein shows that these present proceedings before the Commission were initiated by Northern. Northern filed its revised tariff sheets calling for higher rates on June 6, 1953. But the higher rates called for were uniform rates for the system and there was the answering claim of the proponents of zoning and rate differentials that the uniform rates of those tariff sheets unduly discriminated against them and that the discrimination should be eliminated by zoning and rate differentials. The Commission manifestly became possessed of jurisdiction of the whole of the controversy as to the raising of its rates and as to discrimination therein, and, although agreement was arrived at by the parties concerning uniform interim rates to be charged, the record in the proceeding was kept open so as to retain for the Commission's determination the duly presented issue of undue discrimination and removal thereof by fixing zones and differentials. Such retention of the issue by the Commission was a part of the agreement of the parties and was included in the approval of the agreement by the Commission. Nothing occurred to divest the Commission of the jurisdiction conferred upon it to decide and act upon the whole issue presented to it.

The Commission's conclusion that it had jurisdiction is strengthened by the decision of the Supreme Court in *United Gas Co. v. Mobile Gas Corp.*, 350 U.S. 332. The Court there declares that "the basic power of the Commission is that given it by Section 5(a) to set aside any rate which it determines after hearing to be * * * unduly discrimina-

tory or preferential. * * * Section 5(a) authorizes the Commission to investigate rates not only 'upon complaint of any State, municipality, State Commission or gas distributing company,' but also 'upon its own motion.' Thus while natural gas companies are understandably not given the same explicit standing to complain of their own contracts as are those who represent the public interest or those who might be discriminated against, there is nothing to prevent them from furnishing to the Commission any relevant information and requesting it to initiate an investigation on its own motion. And if the Commission after hearing, determines the contract rate [of a natural gas company] to be so low as to conflict with the public interest, it may, under Section 5(a), authorize the natural gas company to file a schedule increasing the rate."

So, in this case, if Northern's uniform rate was, as alleged, unduly discriminatory, and if it was necessary or appropriate for the Commission to establish zones and differentials in order to eliminate such discrimination, nothing contained in the Proviso of 5(a) restricted the Commission's power to do so. The Commission would not be violating the Proviso of 5(a) by ordering Northern to reduce its existing rates in Zone 2 and authorizing it to increase its existing rates in Zone 3, through the use of an approved differential, in order to balance its revenues. This is what we construe the effect of the Commission's decision and order to be.

The revised tariff filed by Northern on July 2, 1954, was accepted by the Commission as compliance with the requirements of Opinion 281 and Order. It was made effective for an interim period pending final decision by the Commission after hearing in Docket No. G-2505 as to the just and reasonable charges Northern should be permitted to demand and collect in connection with new tariff sheets raising rates filed by it. Such new tariff sheets were filed by Northern on July 2, 1954, designed to increase its revenues from jurisdictional sales $8,128,405 annually over the revenues estimated to be produced by the schedule made effective pursuant to the approved settlement in Docket No. G-2217 pro-

ceeding. The zone rates and charges were made subject to refund by Northern of such portion thereof as might be subsequently ordered by the Commission after further proceedings in Docket No. G-2505, including hearings. There is and can be no question that the Commission was given the power under the Act to determine whether or not a natural gas company's uniform rates are unduly discriminatory, and it is equally clear that where such discimination is found to exist, the Commission was empowered to eliminate it by establishing zoning and rate differentials.

We hold that the Commission regularly acquired and retained jurisdiction in respect to zoning and resulting rate differentials for Northern Natural Gas Company in this case.

The grounds upon which the petitioners seek reversal of the Commission's Opinion No. 281 and Order, additional to the matter of the proviso of 5(a), are stated in somewhat different forms in their several briefs, and without reiterating the characterizations of alleged errors as "arbitrary," "capricious," "abuse of discretion," "contrary to law," etc., we epitomize those contentions meriting discussion as follows:

Petitioners contend:

1. That the finding that the distance Northern transmits the gas it sells is the controlling factor in determining its cost of transmission so that its charging uniform rates throughout its service area (excepting the Argus area) was unduly discriminatory and preferential was not based on and is not supported by substantial evidence;

2. That the zone lines have been fixed without substantial evidence and upon evidence outside the record;

3. That the Commission erred in establishing the zones upon consideration of evidence not shown in the record in respect to new construction authorized in Docket No. G-2063 and without determining costs of the new construction;

4. That the Commission erred in establishing lines of the zones without giving petitioners a hearing upon a proposal to establish the particular lines fixed;

5. That there was no evidence of changed conditions justifying departure from the Commission's approval of Northern's uniform rates. *Colorado Interstate Co. v. Commission,* 324 U. S. 581;

6. That the Commission erroneously failed to find as shown by the evidence that increased rate in Zone 3 is likely to price gas out of the industrial market in that area.

1. *Claimed insufficiency of the evidence.*

The Commission declared the basic question for its decision in the proceeding was "whether the present rate structure of Northern is unduly discriminatory or preferential" in contravention of Section 4(b), 15 U.S.C.A. 717c(b), which provides "No natural gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage * * *." And having considered the question and evidence bearing on it, the Commission stated:

"The matter now before us involves a determination as to whether unlawful discrimination or preference is created by the exaction from all customers on a transmission system of identical, uniform rates when the points of delivery to the several customers are as much as 600 miles apart. We find, under the circumstances of this case, that Northern's uniformly applicable rates and charges are unduly discriminatory as to some of its customers and unlawfully preferential as to others."

The Commission included the declaration in its opinion that "it is a simple economic fact that the delivery cost of natural gas increases in close proportion to the length of the transmission line of any given size" and it adverted in that connection to the fact in evidence that "transmission expense amounting to $50,500,000 constitutes 55 per cent

of Northern's total cost of service and 96 per cent of the total for items other than gas production expense." Inasmuch as natural gas can only be moved through the pipe by application to it of force that costs money to apply, there has been no attempt to dispute "the simple economic fact" of the Commission's finding where one sized pipe is used. The cost per Mcf is less where larger pipe is used and kept filled under greater constant pressure.

The Commission further declared:

"* * * unless other circumstances are present which outweigh the importance of the length of transmission required to effect delivery, the distance factor is the prime determinant of the cost of rendering service. Since in our view of this record there are no such circumstances present to counterbalance the distance factor, we conclude that the distance of transmission required to effect deliveries at the various points of sale by Northern reflects with reasonable accuracy the relative cost of providing service to its customers. We further find and conclude that Northern's present practice of demanding and collecting uniform rate throughout the length and breadth of its area of service for the sale of natural gas for resale is unjust, unreasonable, unduly discriminatory and preferential. This practice results in the shifting of transmission cost from those whose service requires its incurrence by reason of the greater transportation distances to others who are not responsible for such cost—and who are not benefited correspondingly."

In reaching its determination that there were no other circumstances present to counterbalance the distance factor, the Commission gave consideration to the cost of service agreed upon in the stipulation and to (a) the distribution of sales along the route of Northern's system and the volume of gas sold; (b) the load factor of such sales; and (c) the comparative benefits to customers situated in the upper and lower reaches of the principal market area derived from the lowered unit cost resulting from the large volumes of gas transmitted through the system.

(a) As to distribution of sales, the Commission found that, although there are 126 points at which jurisdictional sales and deliveries are effected in the area north of the Kansas-Nebraska boundary, wherein 99.65 per cent of the total estimated jurisdictional sales were made, sales at 8 principal points represented over 71 per cent of Northern's total estimated jurisdictional sales in 1954. The facts concerning deliveries at these points are shown in the following tabulation:

Delivery Point	Estimated Annual Sales 1954 (Mcf)	Percentage of Total Annual Jurisdictional Sales	Percentage Load Factor of Sales	Weighted Average Miles of Haul—Transmission System
Lincoln	10,866,200	4.63	76.19	447.62
Omaha	26,345,000	11.23	78.27	480.61
Council Bluffs	6,053,600	2.58	77.02	483.96
Sioux City	9,826,400	4.19	75.87	560.46
Des Moines	25,352,400	10.81	81.75	625.91
Sioux Falls	7,358,800	3.14	81.10	642.92
Minneapolis	55,013,000	23.45	70.30	795.59
St. Paul	25,922,200	11.05	83.27	803.37
Total	166,737,600	71.08	76.41 Ave.	666.65 Ave.
Jurisdictional Sales System Total	234,588,200	100.00	76.39 Ave.	662.00 Ave.

The record also shows for each other point of delivery by Northern the amount of gas delivered annually, the volume of gas delivered during the period of peak demands, and the miles of transmission required to effect delivery at such points of deliveries. It was fairly inferable from that evidence that there is no such concentration of sales in a single area as would countervail against the factor of distance, the mileage of haul, and the Commission so found. The Commission further found that "While it is true that 37.5 per cent of the total estimated jurisdictional sales for 1954 were made at or near the terminus of Northern's system, the distribution of the remainder of these sales along the system is such as to foreclose a finding that sales at the farthest points of the system are so predominate as to be of controlling consideration rather than the distance fac-

tor." This finding of the Commission is supported by the following tabulation in the Opinion No. 281 showing the distribution of jurisdictional sales along the length of Northern's system, and is corroborated by the extensive detailed evidence respecting each and every point of delivery.

Distance in Miles from Source of Gas Supply	Estimated Jurisdictional Sales for Year 1954 (Mcf)	Percentage of Total Jurisdictional Sales
0 - 400	1,826,400	0.778
401 - 500	47,520,800	20.257
501 - 600	20,025,500	8.537
601 - 700	61,954,900	26.410
701 - 803	103,260,600	44.018

(b) Turning to a consideration of the load factor of jurisdictional sales on the system, the Commission found that the load factor of sales in the State of Minnesota, the most remote from the source of gas supply, was the lowest of any state served by Northern and lower than the system average. The annual load factor of jurisdictional sales in Minnesota was 73.80 per cent.[2] In other states it ranged from 76.92 per cent to 80.74 per cent, with a system average of 76.38 per cent. Load factor as here used reflects the relationship between average daily deliveries and the deliveries in the peak period. The matter of load factor is of importance because, for any given length and size of transmission line, delivery cost per Mcf increases as the load factor at which the line is operated decreases. As the Commission pointed out: "This generality simply gives expression to the mathematical fact that more complete utilization of any given capital facilities involving fixed costs will result in declining unit costs."[3] Therefore, as the Commission properly found, the lower load factor of sales in the State of Minnesota tended to depress the load factor of the system and thus contributed to a higher unit cost for all gas delivered from the system.

[2] The load factor of sales in Minneapolis, the largest single customer, was the lowest of the group of major markets.

[3] Citing "F. P. C. Docket No. G-580, Natural Gas Investigation, Smith-Wimberly Report, page 260; Hamilton Cost as a Standard for Price, 4 Law and Cont. Prob. 321, 330."

(c) As to the comparative benefits, the Commission had before it the testimony of expert witnesses presented by the customer Proponents of zones and rate differentials and by the Commission's staff. The witness presented by the Proponents, Mr. N. Knowles Davis, has been the Chief Engineer of the Georgia Public Service Commission for about twenty years and sometimes serves as a private consultant, as in this proceeding. It was Mr. Davis' opinion that, if the total cost of service of a natural-gas pipe-line system is to be equitably distributed among the customers of the system, it is essential that recognition be given to the cost of service by rate zones; that to have a flat demand and commodity rate uniformly applicable throughout the length of a long pipe line results in discrimination; that customers located in a zone nearer the source of gas supply should not contribute to a rate of return on plant facilities which are in no way used to furnish service to the zone in which they are located; and that the principle of cost allocation by rate zones and the establishment of rates based on such cost allocation is sound and logical and equitable to all concerned.

This witness also expressed the opinion that cost of service varies with the distance transported; and that recognition of this variable cost of service with distance requires zone rates for the transportation of natural gas if equitable charges for the service are to be applied.

With particular reference to the system of Northern, Mr. Davis expressed the following opinions, which were arrived at after a detailed study of the system and operations of the company:

"In the first place, the Northern Natural System extends between eight and nine hundred miles geographically from the source of its supply to its terminus.

"In the second place, the line does not alone serve a single primary area at or near its terminus. This is not a case where the pipeline extends from its source of supply to a single market at its terminus.

"In my opinion a line of this length with a market distributed as it is along this line requires the establishment of rate zones and zone rates in order to equitably distribute the total cost of its service among its market customers.

"In my opinion zone rates are required by reason of the length of a line and the distribution of deliveries along a line. When you have a relatively long line and substantial market areas at considerable distance from one another, it becomes essential, in my view, to provide zone rates in order to eliminate what seems to me to be unreasonable discrimination."

This witness was of opinion that, although capacity of the line enters into it and to quite an extent the distribution of the load along the line, the length of the line is more important than any other factor.

The expert witness presented by the Commission's staff, Mr. Joseph J. Curry, also expressed the opinion that the then existing rate structure of Northern providing uniform rates throughout the system was inequitable, and that the establishment of service zones and zone rate differentials on a proper basis would result in a more equitable distribution and assessment of the transmission cost of service. In the opinion of this witness the fixing of service zones with proper rate differentials was required to give recognition to the miles of haul required in rendering service to the various customers of Northern.

The record also shows that the Commission gave due consideration to the evidence against zoning. It weighed the testimony of witnesses called by the petitioners herein and their studies of Northern, its history, operations and customer relations. The Commission also had before it and considered the carefully prepared decision of the informed Trial Examiner as well as the briefs and arguments of the opponents of zoning. We also have considered the same, and we are satisfied that there is substantial evidence supporting the findings and conclusions of the Commission that Northern's uniform rate structure subjects some of its cus-

tomers to undue discrimination and is unduly preferential to others. Even though a different conclusion could have been drawn, as it was by the Trial Examiner, it cannot be held that the Commission was plainly in error. Section 19(b) of the Natural Gas Act makes such findings conclusive when they are so supported, 15 U.S.C.A. 717r(b), and they should be affirmed. *Colorado Interstate Gas Company v. Federal Power Commission,* 8th Cir., 142 F. 2d 943, 961, affirmed, 324 U.S. 581.

2. *As to the zone lines fixed by the Commission.*

The Commission found on study of the plans for zoning that were proposed by the expert witnesses and explained by testimony that, although each tended to eliminate some discrimination resulting from Northern's uniform rate, each left certain unjust inequalities. The zone plan referred to as Staff Proposal B, which was urged as most appropriate for adoption by the Staff, is basically the same as that decided on by the Commission except that the Commission, on closer study, found instances where sales at some points near the proposed zone border line would be made at the lower rate, although actually requiring transmission through main and lateral line facilities for a greater total distance than some other sales to be made at a higher zone rate. The principal difference between the Staff's recommended zoning and that fixed by the Commission is found in the areas in the vicinity of Beatrice, Paullina and Ogden compressor stations. In these areas where the Staff proposed that the zone boundaries be fixed at the compressor stations, the Commission modified the zone boundaries to include sales immediately beyond and in the vicinity of the stations. The Commission simply brought the zones in a little closer conformity to its finding that the distance of the haul was the controlling factor in determining cost of transmission.

As noted above, it was a part of the Commission approved agreement that Northern should incorporate in revised rate schedules filed to become effective on or after December 27, 1954, "the method and principles found by

the Commission, subject to judicial review, to be proper as to zone and rate differentials with due regard to the reasonable cost of service." But when Northern filed its new schedules for increased rates and charges on July 2, 1954, which were first suspended but later made effective as of December 27, 1954, subject to refund, the Commission had not issued its Opinion and Order as to zones and differentials, and when it did issue them on May 20, 1955, Northern's new rates had become (conditionally) effective upon a uniform basis.

Accordingly, the Commission undertook to determine by cost allocation principles, referred to in the Opinion, what the rates for the zones would be if computed on the full cost of service claimed by Northern. As so computed, the rates indicated that the differential would be 3.06 cents per Mcf. But the Commission did not impose that differential. It ordered the revised schedules to reflect a differential between zones of "approximately 2.00 cents per Mcf."

We think that the Commission made no more use of the record evidence it found furnished by Northern in Docket G-2505 and Docket G-2063 (outside of this G-2217 record) than to verify certain mathematically computed measurements of distances and to assure itself that the zone differential it prescribed (subject to reconsideration and refund in the pending Docket G-2505 proceeding) was substantially less as appears without dispute than would be shown on the hearing.

We find therefore that the use the Commission made of Northern's record evidence in Docket G-2505 that was not included in the hearing of these proceedings of Docket G-2217 was not the basis of its determination of discrimination and to the extent that that evidence influenced the rate differential arrived at, it tended to and was used to reduce the amount thereof and did not prejudice the petitioners. There was no denial of due process.

3. *As to new construction.*

The record shows that at the time of the hearing before the Examiner, March through June, 1954, Northern had commenced construction of lateral lines to some 60 or 70 new jurisdictional sales communities, such service having been authorized by Commission Opinion and Order No. 268 issued March 11, 1954, Docket G-2063. These laterals were completed by December 27, 1954, after the hearing before the Examiner herein was terminated and his decision issued. The new construction cost about $14,000,000 and the new sales and related revenues estimated increased investment and were reported to the Commission by Northern in connection with its filing of new schedules for increased (uniform) rates and charges on July 2, 1954, above referred to. The Commission suspended the schedules but they were made effective and uniform rates were collected under them as of December 27, 1954, subject to refund.

As set forth above, it was part of the Commission approved stipulation for settlement that Northern should incorporate in its new schedules, which were to become effective December 27, 1954, "the methods and principles found by the Commission, subject to judicial review, to be proper as to zone and rate differentials with due regard to the recovery of reasonable cost of service."

In view of the new construction and the new rate filings, the Commission did not attempt to hold Northern to the precise terms of the stipulation or the computations that were submitted with it. But it is clear on the record that, if it should appear in the impending hearings in the proceeding in Docket G-2505 that the differentials ought to be less than 2.00 cents per Mcf prescribed or that an excessive rate is being or has been collected, the opportunity is there presented for the Commission to make adjustment and require refunds. The present rates of Northern are effective at this time on an interim basis. We find no impediment to the decision or justification for reversal of its Opinion in the fact that there was this new construction going on during the hearings and completed afterwards. There is no reason

to infer that the new construction changed the basic conclusions upon which the Commission acted.

4. *As to the lack of hearing on the particular zone lines prescribed.*

The Commission observed:

"In theory, the ideal non-discriminatory, and non-preferential rate structure would be one designed to assess each point of sale and delivery with the total of the various cost components incurred in the rendering of service to each point. But any attempt to arrive at such perfection would not only be delusory, [*Colorado Interstate Gas Company v. Federal Power Commission, et al.*, 324 U.S. 581, 589; *Hamilton, Cost as a Standard of Price, supra* (4 Law and Const. Prob. 321); (F.P.C.) Op. No. 225, *In the Matter of Atlantic Seaboard Corporation, et al.*, pp. 17-19 (mimeo. ed.)], but also impracticable and infeasible from both the management and regulatory point of view. In the circumstances of this case the only practical and reasonable approach to an equitable solution is the establishment of service zones—with rate differentials—as urged by the Proponents of zoning and the Staff."[4]

After noting the zoning proposals advanced by the Proponents of zoning, the four alternative bases for zoning proposed by the Staff, and the voluntary suggestion of the Presiding Examiner as to what he considered would be proper service zones, the Commission stated:

"After detailed consideration of the record, we have concluded that none of the zoning plans presented by the Proponents and the Staff or the modified plan which the Examiner finds most feasible are appropriate and accept-

[4] In effect much of the argument of petitioners here constitutes attack upon this conclusion of the Commission. It is contended that the Commission should have had more data respecting the comparative costs of transmission to all the different areas and points of delivery in the system, but we think the Commission's declaration as to what was practical or feasible from the management and regulatory point of view is entitled to weight and may not be disregarded.

able. While each might as claimed tend to eliminate or reduce the discriminations and preferences existing under the present rates of Northern, the facts are clear that other inequities would be created by the establishment of zones according to any of these plans.

"Under each of these plans, including that found most proper by the [Presiding Examiner's] Decision, determination of the zone in which a particular sale is made would be fixed by the point on the main line from which the lateral line enabling such sales takes off. All of Northern's sales of gas for resale are effected at the city gates of the communities served. In most instances these sales are made at the terminii of lateral lines branching from the main line transmission facilities. Thus, the total distance of transmission to each point of delivery is represented by the aggregate of the mileage of the transmission through both the main line and the lateral line serving each point of sale. As a result, as is elaborately pointed out by the Opponents, under each of these methods of zoning the total mileage of transmission to certain points in zones closer to the source of supply is greater than the mileage to other points of sale in zones farther removed from the source. Under each of the plans considered, including the Examiner's, deliveries to certain points requiring the greater mileage of transmission would be made at the lesser rate."

Whereupon, after noting these findings were sufficient in the Commission's view "to condemn each of these methods of zoning" advanced by the Proponents and the Staff, the Commission pointed out other additional reasons why it did not find any of such proposals wholly acceptable. After analyzing the evidence, it concluded:

"* * * that the most appropriate and practicable method would be the establishment of three zones on Northern's system with zone boundaries as depicted on the map following this page. * * * This plan, in our view, provides the most effective and equitable basis for eliminating the present unlawful discrimination and preference.

"As noted previously, the Bushton Compressor Station is the last point of input of gas into the main-line facilities. Under this plan, the service area north of the Bushton station wherein more than 99 per cent of the jurisdictional sales are made is divided into three zones which are as nearly equal as they can reasonably be so far as transmission distances are involved."

The petitioners contend that when the Commission decided to reject the several defined zones which were proposed and opposed on the hearing before the Trial Examiner, it should have given notice and held a hearing in respect to the particular zone lines which it contemplated establishing. They argue that they were denied due process in this respect.

It cannot be denied that the course contended for would have been held appropriate if the Commission had followed it, but we do not find a denial of due process in the course that was followed. The Commission is "one of the agencies presumably equipped or informed by experience to deal with a specialized field of knowledge, whose findings within that field carry the authority of an expertness which courts do not possess." *Universal Camera Corp. v. National Labor Relations Board*, 340 U.S. 474, 488. It has been delegated by the Congress to administer the Natural Gas Act "with power to draw inferences from the facts." Its "function is not only to appraise the facts and to draw inferences from them, but also to bring to bear upon the problem an expert judgment." *United States v. Detroit & Cleveland Navigation Co.*, 326 U.S. 236, 241, and particularly its findings and directives need not be based directly on the expressed opinion of experts, but may be drawn from the facts. *Market Street R. Co. v. Commissioner*, 324 U. S. 548, 559, 560.

In this instance the evidence before it, taken in sixteen days of hearing and including some 2,000 pages of testimony and 46 exhibits, many of which are quite voluminous, was sufficient to enable the Commission to establish just and proper zone lines. It had to make only slight changes

in the zone lines testified about by the experts. In the hearings, counsel for the Opponents brought out on cross examination of the Staff witness concerning the Staff's proposed zones, instances where a higher rate would be charged at points near the zone boundaries although the total distance of transmission to the points of delivery was less than to other points where the charge would be less. This inequity was eliminated by the Commission by sharply zig-zagging the zone boundary lines. There is no suggestion of any mistake or oversight in drawing the zone lines as the Commission drew them. If such should arise, it would be for consideration and correction in Docket G-2505.

The major defense to the charge that uniform rates were unduly discriminatory was that it was illogical and arbitrary to allocate transmission costs on the mileage basis alone. The petitioners contend that considerations as to volume of gas sold, size of the pipes used, the annual load factor, and competition of other fuels counterbalances the distance factor, so that costs are not in proportion to distance and the public interest is not served by zoning. But the record reflects that the Commission did not fail to consider any of these matters of defense. It had the figures in detail as to each of the factors and the opinions of experts as to the relevancy of each of them to the transmission cost.

The petitioners also insisted that several of the elements necessary to make a determination on this major issue were not shown by evidence in the record. Thus, although it was shown that there are about 2,000 miles of branch lines and 3,200 miles of main line and the pipes of the branch lines and of the main lines vary in size, there was no specific finding as to just what effect this variance had on the unit transmission cost. Petitioners presented testimony supported by exhibits tending to show the benefits in costs which consumers below Minnesota derived from the transmission and sale of gas to that area. It was also argued that new construction to serve some sixty or seventy additional communities might affect the conclusion that distance alone was determinable of the cost of transmission.

But the conclusion arrived at by the Commission, after considering all the contentions, was that none of these factors nor all together sufficed to overcome the evidence that it was the distance which determined the relative cost of transmitting the gas to the delivery points of the system; and that the cost increased and lessened in direct proportion to the distance. That conclusion was within the province of the Commission.

5. *As to Commission's former sanctioning of uniform rates.*

The record shows that the Commission has on several occasions since the effective date of the Natural Gas Act in 1938 adverted to the matter of Northern's uniform rates, at all times consistently charged by it with Commission permission throughout the area of service (except as to the Argus system). In *Trunkline Gas Supply Company*, Opinion No. 178, Docket No. G-882, 8 F.P.C. 250 (April 29, 1949), the Commission expressly stated that:

"It is significant to note that throughout this period of expansion [1945-1949], and taking into consideration the many problems relating thereto from the standpoint of operation, costs and earning, Northern Natural has never seen fit to vary from its policy of a uniform system-wide rate structure for sale from its main line transmission system.

"Accordingly, from this present record it appears that Northern should continue its present practice of charging a uniform demand-commodity form of rate for all sale-for-resale services on its main line system after it commences its purchases of gas from Trunkline. This is consistent with Commission's past position in that it held that 'In the absence of compelling reasons to the contrary, it is good and desirable practice to fix rates that are uniform.'"

In *State Corporation Commission of Kansas v. Federal Power Commission*, 8th Cir., 206 F. 2d 690, 713, this court agreed with the conclusion of the Commission then under review that the Proponents of zone rates for Northern had "made no record in [the] case to afford a basis for the

establishment of such rates." It is also evident that the Commission Staff thought that it was settled in the *Trunkline* case that, until compelling reasons were shown to the contrary, Northern should charge uniform rates.

Petitioners' contention is to the effect that the Commission was precluded from fixing zones and differential rates for Northern.

We do not so conclude. It appears that this case presents the first instance in which the Commission has made what it has deemed to be a sufficient study of the facts to enable it to make definite and positive finding that Northern's uniform rates are in fact unduly discriminatory. In this case the Commission had available to it at the outset the cost allocations which had been considered and agreed to by all parties to the proceedings and were approved by the Commission. The situation was contrasted with that presented to this Court where conflict continued respecting the allocations. Neither the Commission nor this Court was bound in that respect to Northern's uniform rates except as the Commission was obliged to recognize and permit them unless and until it was proved by substantial evidence that they were unduly discriminatory. We do not find sufficient cause to upset that ruling of the Commission.

6. *As to pricing gas out of upper zone market.*

The Commission considered the contention that the increase of rates in zone 3 would result in the loss of industrial sales to competitive fuels, but found the evidence less than convincing. It permitted Northern, if it chooses to do so, to maintain in the rate schedules files pursuant to the Order in the instant matter a uniform commodity charge throughout the system and to adjust the demand component of the rates to provide the differential between zones of approximately 2.00 cents per Mcf at a 70 per cent load factor.

Our own consideration of the evidence concerning the effect of the zoning and differential upon competition with other fuels does not compel conclusion, on the present

record, contrary to that reached by the Commission. The testimony is meager. The matter is for hearing in G-2505 and the statements concerning it in the Opinion reflect that the Commission will not arbitrarily or unfairly limit the rights of Northern or the interests of its customers in the field of competition.

On review of the whole record, we conclude that the Commission has acted in a matter within its jurisdiction; that its findings are supported by substantial evidence and are not contrary to the evidence; that the conclusions are not contrary to law or erroneous; and that the Opinion and Order should be sustained. The points raised and argued in the briefs have been considered, though discussion of some is deemed unnecessary. The Opinion and Order are

Affirmed.

A true copy.

Attest: E. E. Koch
Clerk, U. S. Court of Appeals, Eighth Circuit.

(United States Eighth Circuit Court Seal)

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1955.
Monday, July 9, 1956.

No. 15412

Interstate Power Company, Northern States Power Company, Western States Utilities Company, Minnesota Valley Natural Gas Company, North Central Public Service Company, Kansas City Power & Light Company (Peoples Gas & Electric Division), Minneapolis Gas Company, State of Minnesota, City of St. Paul, Minnesota, and City of Minneapolis, Minnesota, Petitioners,

vs.

Federal Power Commission.

No. 15424

Northern Natural Gas Company, a corporation, Petitioner,

vs.

Federal Power Commission.

(Judgment.)

Petitions to Review, Set Aside and Reverse Order of the Federal Power Commission.

These matters came on to be heard on the Petitions to review, set aside and reverse an Order of the Federal Power Commission on its Opinion No. 281, in Docket No. G-2217, issued May 20, 1955, and were argued by counsel.

On consideration whereof, it is now here ordered, and adjudged by this Court that the Opinion and Order of the said Federal Power Commission in these matters be, and the same are hereby, affirmed. Opinion this day filed.

July 9th, 1956.

APPENDIX D

ADMINISTRATIVE PROCEDURE ACT

(Act of Congress of June 11, 1946, c. 324, 60 Stat. 237-244, 5 U. S. C., Secs. 1001-1011; as amended.)

Section 7(c) and (d), (5 U. S. C. §§1006(c) and (d)).

7(c) Except as statutes otherwise provide, the proponent of a rule or order shall have the burden of proof. Any oral or documentary evidence may be received, but every agency shall as a matter of policy provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence and no sanction shall be imposed or rule or order be issued except upon consideration of the whole record or such portions thereof as may be cited by any party and as supported by and in accordance with the reliable, probative, and substantial evidence. Every party shall have the right to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses any agency may, where the interest of any party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

7(d) The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with section 1007 of this title and, upon payment of lawfully prescribed costs, shall be made available to the parties. Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record any party shall on timely request be afforded an opportunity to show the contrary.

NATURAL GAS ACT

(Act of Congress of June 21, 1938, c. 556, 52 Stat. 821-833; 15 U. S. C., §§717-717w; as amended)

Section 4(b), (15 U. S. C., §717c(b)).

4(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

Section 5(a), (15 U. S. C., §717d(a)).

5(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however, That* the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

Section 19(b), (15 U. S. C., §717r(b)).

19(b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be

conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, Secs. 346 and 347).

Office - Supreme Court, U.S.
FILED
OCT 3 1956
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1956

No. 476

NORTHERN NATURAL GAS COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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Law Briefs—OMAHA LINO-SLUG PRINTING CO.—418 So. 15th St.

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IN THE

Supreme Court of the United States

October Term, 1956

No. ———

NORTHERN NATURAL GAS COMPANY,
Petitioner,

vs.

FEDERAL POWER COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Northern Natural Gas Company, Petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered on July 9, 1956, in the cases of *Northern Natural Gas Company vs. Federal Power Commission,* No. 15,424, and *Interstate Power Company, et al., vs. Federal Power Commission,* No. 15,412.[1]

1 Cases Nos. 15,424 and 15,412, which involved common questions of law and fact, were consolidated for hearing by order of the Court of Appeals. A petition for writ of certiorari was filed by Petitioners in Case No. 15,412 on September 27, 1956, and docketed in this Court as Case No. 459.

OPINIONS BELOW

The Opinion of the Court of Appeals (App. A, pp. 27-57, infra)[2] is reported at —— F. 2d —— (R. Vol. IV, 18-47).[3] The Opinion and Order of the Federal Power Commission (App. B, pp. 59-107, infra) is reported at 9 PUR 3d 8 (R. 91-133).

JURISDICTION

The judgment of the Court of Appeals was entered on July 9, 1956 (App. C, p. 109, infra). Petitioner (and also the petitioners in case No. 459) filed a timely petition for rehearing which was denied August 10, 1956.

Jurisdiction is conferred upon this Court by 28 U. S. C. §1254(1), 63 Stat. 928 and 15 U. S. C. §717r(b), 52 Stat. 831 (1938).

QUESTION PRESENTED

In a final order establishing service zones and rate differentials on Petitioner's natural gas transmission system—as opposed to Petitioner's long-approved historical practice of charging uniform rates in its principal market area—is the Federal Power Commission required, under the Administrative Procedure Act §7(d), to afford Petitioner an opportunity to show the contrary where such final order is, without notice, based on a zoning theory, zone lines, cost of service, sales volumes and pipeline mileage data not appearing in the evidence in the record?

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2 "App." refers to the Appendices to this petition.

3 The record references are to the printed pages of the Joint Printed Record filed in the Court of Appeals in Cases Nos. 15,424 and 15,412. This record, supplemented to include the proceedings in the court below, was filed in this Court by the petitioners in Case No. 459, and serves as a single consolidated record in these cases. Record references to proceedings in the court below will include the notation "Vol. IV".

STATUTE INVOLVED

The principal statute involved is §7(d) of the Administrative Procedure Act, 60 Stat. 241, 5 U. S. C. §1006(d), which provides:

> (d) The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision in accordance with section 1007 of this title and, upon payment of lawfully prescribed costs, shall be made available to the parties. Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary.

Pertinent excerpts of the legislative history of the above quoted statutory provision are printed in Appendix D, pp. 111-113, infra.

STATEMENT

Northern Natural Gas Company (Northern), with its principal place of business in Omaha, Nebraska, operates a natural gas pipeline transmission system extending from the Texas Panhandle and Hugoton, Kansas gas fields to the Twin Cities of Minneapolis and St. Paul, Minnesota (R. 141). It transports and sells natural gas for resale to various utilities located in Kansas, Nebraska, Iowa, South Dakota and Minnesota (App. B, pp. 67-68, infra). It is, therefore, a "natural-gas company" within the meaning of the Natural Gas Act (App. B, p. 101, infra). Its rates and charges for sales in interstate commerce of natural gas for resale are accordingly within the jurisdiction of the Federal Power Commission (Commission) and of the Court of Appeals on review under §19(b) of the Natural Gas Act, 15 U. S. C. §717r(b).

The proceedings herein, identified in the records of the Commission as Docket No. G-2217, were initiated on June 26, 1953, by Northern filing with the Commission proposed increases in its rates and charges subject to the jurisdiction of the Commission (App. B, p. 62, infra). Such increases were on a uniform basis throughout Northern's principal market area[4] in accordance with Northern's long historical practice, beginning with the inception of operations in 1933 and approved by the Commission subsequent to regulation, of charging and collecting uniform rates for sales and service throughout such area (R. 87).

On January 21, 1954, a final agreement, approved by the Commission (R. 155-166), was reached by the parties respecting all matters involved in said Docket No. G-2217, excepting the single issue of service zones and differentials in rates. The Commission ordered further hearings to be held on this issue.

Three[5] of Northern's twenty-seven utility customers contended, in the course of such hearings, that Northern's uniform rates were unduly discriminatory and unlawful as to them because of their closer proximity to the source of gas supply (App. B, p. 69, infra). Ten (10) of Northern's utility customers, the State of Minnesota and the Cities of St. Paul and Minneapolis, all of whom had intervened in Docket No. G-2217, opposed zone rates and favored uniform rates.[6] The Commission Staff refused to

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4 The 400-mile by 300-mile area north of the Kansas-Nebraska border wherein 99.65% of Northern's jurisdictional sales are made (R. 65, 710).

5 Council Bluffs Gas Company (Council Bluffs, Iowa), Metropolitan Utilities District of Omaha (Omaha, Nebraska) and Central Electric and Gas Company (Lincoln, Nebraska). These Companies will hereinafter sometimes be referred to as the "Proponents" of zone rates.

6 These parties will hereinafter sometimes be referred to as the "Opponents" of zone rates.

take a position for or against zoning during the hearings but, after the record was closed, filed a Brief urging the establishment of service zones and rate differentials (App. B, pp. 66-67, infra). Northern opposed zoning its system on the ground, *inter alia,* that, since its system was originally designed to serve its present terminus, uniform rates permitted all the beneficiaries of the line to share equitably in the cost (R. 144; 1026-1027).[7]

The Proponents introduced one (1) zoning proposal in the record which divided Northern's system into two zones, the zone line traversing such system on the inlet (south) side of the Hooper, Nebraska, and Oakland, Iowa, compressor stations (App. B, p. 83, infra). A Commission Staff witness, appearing in a unique individual capacity and not as a representative of the Commission, introduced in the record four (4) different plans for zoning Northern's system (App. B, pp. 83-84, infra). These various incongruous plans included proposals of three (3), four (4), six (6) and eight (8) service zones. The Staff witness testified that, in his opinion, zone lines on Northern's system should be drawn either at compressor stations (R. 520-521), or at state boundaries (R. 520), or at lines drawn as subdivisions of states (R. 523-525). *Neither the witness for the Proponents nor the Staff Witness testified to or recommended that zoning on the basis of equidistant pipeline miles (as the Commission prescribed) was proper.*

Northern and the Opponents of zone rates vigorously attacked the zoning proposals introduced in the record. Through cross-examination and rebuttal they

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7 The Commission and the Court below ignored the clear holding of this Court on this precise point in Colorado Interstate Gas Company vs. F. P. C., 324 U. S. 581, 591 (See p. 8, and n. 13, infra).

clearly established the inherent inequity and obvious discrimination in each of the proposed zoning plans (see, e. g., R. 440-443).

In his initial decision (R. 58-90) the Presiding Examiner rejected all five (5) of the zoning proposals introduced in the record. He found that "neither the proposal of the three proponent companies or any one of the four proposals introduced by the Staff offer a zoning system which is both practical and equitable and, in addition thereto, contains a formula by which future costs can be firmly allocated between zones" (R. 81). The Examiner concluded that Northern's uniform rates had not been shown to be unduly discriminatory or preferential[8] and that the public interest did not require the establishment of service zones and rate differentials on Northern's system (R. 90).[9]

The Commission, as did the Examiner, rejected all five (5) of the zoning proposals introduced in the record (App. B, pp. 84-85, infra). In its final decision the Commission found that none of the zoning plans introduced in the record "are appropriate and acceptable" (App. B, p. 85, infra). It further found, as contended by Northern and the Opponents, that the establishment of zones according to any of the plans proposed in the record would create "inequities" not presently found under Northern's uniform rates (App. B, p. 85, infra). The Commission's action, had it stopped at this point, would have been unassailable by any of the parties because its findings

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8 The Examiner had proceeded on the logical basis that "if it appears that inequities created by zoning at this time could reasonably be expected to be equal to or greater than those produced by the present [uniform] form of rate" (R. 71), then the public interest could not be found to require zoning.

9 The Examiner's Report is as much a part of the record as the testimony. **Universal Camera Corp. v. N. L. R. B.**, 340 U. S. 474, 493.

were based directly on record evidence. But it proceeded to go beyond the record and prescribe a method of zoning of its own creation (App. B, pp. 86-91, infra),[10] entirely foreign to any plan submitted in the record. The Commission's method of zoning was based on the theory that zone lines should be drawn so that the resulting zones are equidistant in respect to pipeline mileage.[11] Northern and the Opponents of zone rates were never given an opportunity to challenge the inequities existing in such a plan of zoning. Their Applications for rehearing before the Commission were summarily denied (R. 207-208). The Court below held that the Commission made only "slight changes"[12] in one of the record zone proposals (App. A, p. 53, infra).

The Commission, after determining the location of the zone lines on Northern's system (App. B, p. 89, infra), next determined the method by which costs should be allocated between zones (App. B, pp. 92-96, infra). For

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10 Here again, to use a time-worn phrase, necessity was the mother of invention. The Commission had previously found (App. B, pp. 72-75, infra), as an initial determination and without relation to zoning, that Northern's uniform rates were unduly discriminatory and preferential per se. (Cf. n. 8, supra.) Having so found, and faced with the obvious defects of the zoning plans of record, as clearly established by Northern and the Opponents on cross-examination and rebuttal, the Commission had to come up with an extra-record zoning plan of its own creation.

11 As previously noted, the zoning plans of record were based on the theory that zone lines should be drawn at compressor stations, state lines, or subdivisions of states (See p. 5, supra).

12 The "slight change" places Des Moines, Iowa, for example, with annual sales of approximately 25,000,000,000 cubic feet (or about 10% of Northern's total annual sales), in a lower rate zone. The zoning plan of Proponents placed Des Moines in the highest rate zone. The zoning plan of the Staff witness which proposed three (3) service zones on Northern's system, as did the Commission in its final order, also placed Des Moines in the highest rate zone.

this purpose it adopted, with some modifications not here pertinent, the so-called "demand-mile commodity-mile" method of allocation[13] proposed by the Staff witness (App. B, p. 95, infra).[14] The Staff witness testified, on cross-examination, that *three basic facts must be known* before transmission costs can be allocated by use of the demand-mile commodity-mile method of allocation.[15] These basic facts are (1) the pipeline mileage to each delivery point, (2) the annual sales volumes

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13 Cf. **Colorado Interstate Gas Company v. F. P. C.**, 324 U. S. 581, 591, wherein the mileage demand basis of allocating transmission costs was rejected by this Court.

14 Under the method of allocating transmission costs normally used by the Commission, the demand costs are allocated between classes of customers on the basis of the use of gas on the average of the three system peak days. Commodity costs normally are allocated on the basis of the annual use of gas. The fundamental difference between this method and that employed by the Staff Witness is that such Witness attempted, by multiplying miles by annual and peak day volumes, to weight the use of gas annually and on peak days by the miles that the gas is hauled.

15 The testimony of the witness in this respect was as follows:

"Q. You mean after determining all of those different cost factors, then you select from the group the transmission cost of service?

A. That is correct.

Q. What do you do with that, then?

A. Transmission cost, we divide it by the Mcf miles to obtain a unit transmission cost for demand, assuming the transmission cost has been allocated into its demand component and its commodity component, obtain the Mcf miles to which demand costs should be assigned and the Mcf miles to which commodity costs should be assigned.

"To determine the Mcf miles, it is necessary to have the volumes of gas which would be sold during the period under consideration on both the peak day and annual, and the number of miles to each delivery point which gas is delivered for the sales. And knowing the number of miles and the volumes of gas to be delivered at each point, the Mcf of miles to that point could be determined, and the total Mcf miles on that basis for the system." (Emphasis added) (R. 928).

at each delivery point, and (3) the peak day sales volumes at each delivery point (R. 928). *It is undisputed that the record in this case contains no evidence of these necessary basic facts pertaining to the mileage and sales volumes on which the Commission based its decision.* The Commission's purported knowledge of these basic facts was derived from sources totally outside the record. These matters, and the Commission's sources of information with respect to them, will be considered in the order stated:

1. *Pipeline mileage to each delivery point.*

After the record in this Docket No. G-2217 proceeding was closed, but before the Commission issued its decision herein, Northern commenced jurisdictional service to sixty (60) new communities, such service being authorized by the Commission in Docket No. G-2063. In attempting, in this Docket No. G-2217 proceeding, to apply the demand-mile commodity-mile method of allocating costs to zones, the Commission used reports of pipeline mileages for the sixty (60) new communities submitted by Northern in Docket No. G-2063, a certificate proceeding totally unrelated to the instant rate proceeding. The information contained in these reports was utterly insufficient to permit the Commission to apply the demand-mile commodity-mile allocation to these new communities. The reason is clear. These reports showed only the pipeline mileage of lateral lines off the main lines and of sublateral lines off the lateral lines, but did not show the take-off points of the sublateral lines from the lateral lines. Thus the Commission had to guess where such take-offs were located. In no one instance did it guess correctly.[16]

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16 In the case of Charles City, Iowa, for example, it missed by approximately 14 miles. Yet in its Opinion No. 281 and order it prescribed zone lines down to the degree of 1/100 of a mile. (App. B, p. 91, infra.)

The Court below erroneously held that the Commission "made no more use of the record [*sic*] evidence it found furnished by Northern in * * * Docket G-2063 (outside of this G-2217 record) than to verify certain mathematically computed measurements of distances * * *" (App. A, p. 48, infra). Since the pipeline mileage figures for the sixty (60) new communities are not in this (Docket No. G-2217) record, the Commission could not possibly "verify" such figures by taking them in the first instance from other documents in its files, where such other documents do not contain the necessary figures.

2. *Annual sales volumes at each delivery point.*

As hereinbefore noted, the Commission Staff witness testified that, in order to use the demand-mile commodity-mile allocation method, it is necessary to know the volume of sales made annually at each delivery point (see n. 15, p. 8, supra). It is an uncontradicted fact that the annual sales volumes for each community, relied on by the Commission in its decision, are not contained in the record evidence nor in any extra-record document but were based on an extra-record *estimate* computed by the Commission.

First, no evidence was introduced in the record from which the annual volumes of sales to each of the sixty (60) new communities authorized to be served, at a cost of approximately $14,000,000, in Docket No. G-2063 could be determined. The Staff witness admitted he did not have this information (R. 943, 957). The Examiner found that the record did not contain such information (R. 88).

Secondly, the record did not contain annual sales volumes for any individual delivery points which the Commission relied on in its final decision. As heretofore noted, throughout Northern's entire history of op-

erations, rates have been charged and collected, in its principal market area, on a uniform basis since its system was designed and constructed to serve its present terminus at Minneapolis and St. Paul, Minnesota (R. 144).[17] Northern's filing in Docket No. G-2217 (the instant case) was *on a basis of uniform rates* and did *not* contain a breakdown of annual sales *for each delivery point* or *by zones*. After the record in the instant case was closed, Northern filed another rate case before the Commission which was designated as Docket No. G-2505. The increased sales and costs estimates, including those associated with the sixty (60) new communities in Docket No. G-2063, contained in the Docket No. G-2505 filing were again on a basis of uniform rates and were not segregated by delivery points or zones. The Commission, in its final order and without notice, utilized the system-wide sales data contained in Docket No. G-2505—which matter had not yet gone to hearing—in determining the rate differential between the zones it prescribed in this case.

Thus the Commission, starting with improper and insufficient extra-record sales data, compounded its error by making highly controversial extra-record computations through the application of equally controversial extra-record ratios to develop the *necessary* sales data upon which its final decision rested. Factually, the figures developed by the Commission outside of this record are, in the case of Zones 2 and 3, in error cumulatively by approximately 10,000,000,000 cubic feet per year.

The Court below whitewashed the foregoing extra-record determinations with the specious statement that the Docket No. G-2505 data was used by the Commission

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17 Cf. **Colorado Interstate Gas Company v. F. P. C.**, 324 U. S. 581, 591-592.

"to assure itself that the zone differential it prescribed (subject to reconsideration and refund in the pending Docket G-2505 proceeding) was substantially less as appears without dispute than would be shown on the hearing" (App. A, pp. 48-49, infra). Since the Commission did not find a differential in rates based on record evidence, it could not possibly "assure" itself, by the use of data and computations not of record, that the rate differentials prescribed are "substantially less" than "would be shown on the hearing."[18]

3. *Peak day sales volumes at each delivery point.*

As in the case of the annual sales volumes (No. 2, supra), the Commission, in its final order, relied on extra-record information, computations and calculations in attempting to determine the necessary peak day sales volumes at individual delivery points on Northern's system. Again the Commission's foray beyond the record took it to Northern's filing in said Docket No. G-2505. That the information was necessary for the application of the demand-mile commodity-mile method of allocation is uncontradicted in the record (R. 928). The Staff witness admitted he did not have this information with respect to the sixty (60) new communities in Docket No. G-2063 (R. 943, 957). The Examiner in his decision found that such information was not in the record (R. 88). Here again the Commission, in its final order and without notice, starting with improper and insufficient extra-record sales data, compounded its error by making

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18 The Court below was referring to the future hearing to be held in Docket No. G-2505 (App. A, p. 49, infra). Judicial review becomes a "costly, time-consuming pageant of no practical value to anyone" (See **F. P. C. v. Hope Natural Gas Co.**, 320 U. S. 591, 645) when an administrative agency action is upheld on review on the basis of the speculative and unknown results of a future administrative hearing.

highly controversial extra-record computations through the application of equally controversial extra-record ratios to develop the *necessary* sales data upon which its final decision rested.

The Court below affirmed the Commission's decision without referring to its action in this respect other than by its general conclusion heretofore quoted (p. 12, supra).[19]

What, if any, actual differentials in costs between zones would be shown when accurate data in respect to pipeline mileages and sales volumes are used, is not known by the Commission, the court or the parties to this day.

Nowhere in the record or in the Commission's opinion is there a statement or finding of the *actual* cost of serving the customers in the zones prescribed by the Commission. It is axiomatic that, absent evidence and findings that a difference in cost of serving between zones actually exists, differentials in rates are neither justified nor required. Furthermore, absent such evidence and findings, no basis exists for the Commission concluding, as it did, that Northern's uniform rates were unduly discriminatory and preferential.

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19 This action of the Court below is in direct conflict with the holding of the Court of Appeals, District of Columbia, in **Mississippi River Fuel Corp. v. Federal Power Commission**, C. A. D. C., 163 F. 2d 433. In that case the Commission paid lip service to the demand-commodity allocation method, then arbitrarily departed therefrom. In reversing the Commission decision, the Court held (163 F. 2d 433, 449): "The Commission cannot announce the applicability of a formula and then distort its application by failure to find accurately the factors required by the formula, or by departing from the essential progress of the formula from premise to conclusion. When the Commission announces principles or formulae as applicable, the validity of its order can be determined only by measuring what it does against the principles it announces."

REASONS FOR GRANTING THE WRIT

The decision of the court below raises a substantial federal question of prime importance which has not been, but should be, settled by this Court.

This case presents the very serious question of whether an administrative agency may, on the basis of information not introduced in evidence, order a regulated company to change its fundamental method of operation and then, upon timely request, refuse such company an opportunity to controvert the information upon which such order is based. The court below has said that it may. Its decision so holding vitally concerns not only this petitioner but the great multitude of persons whose business operations are subject to governmental regulation under the processes of administrative agencies. If this decision, sanctioning an administrative agency's use of material facts not appearing in the evidence in the record, is permitted to stand, then the guarantee of a fair hearing before administrative tribunals, as expressed in the provisions of the Administrative Procedure Act and the pronouncements of this Court, becomes a meaningless thing.

The decision of the court below is in direct conflict with and diametrically opposed to the express provisions of §7(d) of the Administrative Procedure Act, 5 U. S. C. §1006(d).[20]

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20 In view of the comparatively recent (1946) enactment of the Administrative Procedure Act, this Court has not had the opportunity to decide such an issue arising under the due process requirements of §7(d). Since the Administrative Procedure Act "created safeguards even narrower than the constitutional ones," **United States v. Morton Salt Co.**, 338 U. S. 632, 644, decisions of this Court on questions of due process (see pp. 19-24, infra) prior to the enactment of such Act may be regarded as minimal requirements.

The provisions of the Administrative Procedure Act, §7(d), 5 U. S. C. §1006(d), are clear in terms and mandatory in character. Said section provides:

> *The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, shall constitute the exclusive record for decision* in accordance with section 1007 of this title and, upon payment of lawfully prescribed costs, shall be made available to the parties. *Where any agency decision rests on official notice of a material fact not appearing in the evidence in the record, any party shall on timely request be afforded an opportunity to show the contrary.* (Emphasis added.)

There can be no doubt that the Commission action in this case, and the court's acquiescence therein, constitute a flagrant violation of this statutory provision.

The violation inheres equally in (a) the initial determination of the Commission (made without benefit of studies based on record evidence) that Northern's uniform rates were unduly discriminatory and preferential and (b) the ultimate conclusion that the prescribed service zones and rate differentials were required to eliminate the alleged undue discrimination and preference.

The Commission-prescribed service zones were never testified to in the record or subjected to cross-examination and rebuttal. The Commission theory that service zones should be equidistant with respect to pipeline mileage was first enunciated, without notice, in its final opinion. In establishing rate differentials between its own-conceived zones, it used cost of service, pipeline mileage and annual and peak-day sales volume figures not appearing

in the evidence in the record. Then it summarily denied the timely request of Northern and the other Opponents of zone rates who sought an opportunity to show the contrary (R. 207-208).

Were these extra-record facts used by the Commission material to its decision? It may be stated, without fear of successful contradiction, that the Commission could not have reached the result it did reach without the use of such facts. An examination of the Commission's decision confirms this more forcefully than any argument (See App. B, pp. 86-98, infra). As previously noted (p. 13, supra), it is axiomatic that charging customers located closer to the source of supply the same rate as customers located farther from the source of supply is not unduly discriminatory or preferential unless it *actually* costs more to render service to customers farther from the source of supply. Stated differently, the charging of uniform rates—as Northern, with the approval of the Commission, has done in its principal market area since the inception of regulation under the Natural Gas Act in 1938—is not unduly discriminatory or preferential *per se*. Further, the Commission, even with its presumed expertise, cannot, *in vacuo* and without the benefit of studies, determine that it costs more to render service to one group of customers than another. The record clearly supports the fact that the extra-record data is a prerequisite to the Commission's conclusion. This is demonstrated most forcefully by the testimony of the witnesses advocating zoning, who testified that they had no opinion with respect to zoning Northern's system, including the sixty (60) new communities and the increased cost of service, since they had made no studies based on the extra-record

data relied on by the Commission.[21] The Commission, by relying in its opinion upon extra-record data, computations and ratios to establish differentials in rates (App. B, pp. 86-98, infra), concedes the materiality of such extra-record data. Absent the Commission's determinations based upon such extra-record data, it could neither justify zoning nor differentials in rates.

Although the provisions of the Administrative Procedure Act, §7(d), are unambiguous, the legislative history of such Act makes it doubly clear that the Commission violated the letter and spirit of the statute in basing its decision on material extra-record facts and then refusing the parties an opportunity to controvert such facts. The purpose and intent of Congress in enacting the provisions of §7(d) are clearly reflected in the following language taken from the Senate Judiciary Committee Print, Administrative Procedure Act, Legislative History, 79th Congress, 1944-46, page 32 (App. D, p. 111, infra):

> The statement of the exclusiveness of the record of the administrative hearing is a necessary recogni-

21 Proponents' witness Davis, when questioned in this regard, stated: "I have made NO STUDY of the figures. I do NOT KNOW whether the revenue is sufficient to cover the costs of service to the extent that there is no burden on the other customers on the line OR WHAT THE FACTS ARE" (R. 449) (Emphasis supplied).

Staff witness Curry, when questioned in this regard, stated that cost of service would have to be recomputed when the 60 new communities were added (R. 947); that "it might possibly make Iowa's rate and Minnesota's rate the SAME" (R. 947); that the addition of such new communities "would probably require recomputation of your zone cost of service, determine what the rates would be, determine whether there IS ANY discrimination which would exist" (R. 955); and, that he did not know whether the addition of the 60 new communities would affect his recommendation for zones (R. 1009) (Emphasis supplied).

> tion that upon it, and *no other evidence,* the further administrative proceedings must be had, *the final administrative decision made, and judicial review be confined.* Unless the record is so recognized as exclusive, the purpose and value of the hearing may be rendered nil, for it is only the record that informs the parties of the evidence for or against them. The rule of official notice is that recommended by the Attorney General's Committee, particularly the safeguard that parties be apprised of matters so noticed and accorded an "opportunity for reopening of the hearing in order to allow the parties to come forward to meet the facts intended to be noticed." (Emphasis added.)

Although Northern and the other Opponents of zone rates specifically charged, both in petitions to review and petitions for rehearing filed in the court below, that the Commission committed reversible error under the Administrative Procedure Act, §7(d), in relying on material facts not contained in the record and in then refusing the parties an opportunity to controvert such facts, the court in its opinion failed and refused to even refer to the Administrative Procedure Act. The Court merely concluded generally that "There was no denial of due process" (App. A, p. 49, infra).

Northern has been substantially prejudiced by the Commission decision and the lack of due process inherent therein. All zoning plans introduced in the record and subjected to the close scrutiny of cross-examination and the weight of rebuttal evidence were defeated and rejected by both the Examiner (R. 81) and the Commission (App. B, pp. 84-85, infra). It was only through the use of these fundamental judicial tools for ascertaining the truth that Northern and the Opponents of zone rates were able to establish the injustice and inequity in the zoning plans proposed. But the zoning plan prescribed by the Com-

mission has never been subjected to the tests of cross-examination and rebuttal. The parties have never had an opportunity to spread its defects upon the record. It cannot be said that the plan adopted removes more inequities than it creates. The Commission's mere statement to that effect does not make it so. Cf. *State Corporation Commission of Kansas v. Federal Power Commission,* 8 Cir., 206 F. 2d 690, 723.[22] Yet the same court in this case concludes that the exercise of the Commission's "expert judgment" sufficiently safeguards the rights of the parties to the extent that cross-examination and rebuttal may be dispensed with (App. A, p. 53, infra).

The final order of the Commission prescribing service zones and rate differentials, contrary to a long approved historical practice of charging and collecting rates on a uniform basis, being based on material facts not appearing in the record, the minimal requirements of constitutional and statutory due process necessitate the granting of an opportunity to controvert those facts.

The decision of the Court of Appeals directly conflicts with the principles previously enunciated in the decisions of this Court.

The decision of the court below is in direct conflict with the principles previously enunciated in the decisions of this Court rendered prior to the enactment of the Administrative Procedure Act, which Act "created safeguards even narrower than the constitutional ones, against arbitrary official encroachment on private rights." *United States v. Morton Salt Co.,* 338

22 See also, **F. P. C. v. Hope Natural Gas Co.,** 320 U. S. 591, 645 (Justice Jackson's dissent).

U. S. 632, 644. It should be emphasized, therefore, that the decisions hereinafter cited are based on less exacting due process requirements than is permitted under the present law.

Interstate Commerce Commission v. Louisville & Nashville Railroad Company, 227 U. S. 88, represents one of the first attempts by an administrative agency to insist upon the validity of its own findings even though the information supporting such findings was never put into evidence. In rejecting this startling claim, entirely foreign to judicial notions of a fair hearing and fair play, this Court laid down the rule to be thereafter observed in the conduct of administrative hearings. It declared (227 U. S. 88, 93):

> All parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents, and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense. In no other way can it test the sufficiency of the facts to support the finding; for otherwise, even though it appeared that the order was without evidence, the manifest deficiency could always be explained on the theory that the Commission had before it extraneous, unknown, but presumptively sufficient information to support the finding.

In *United States v. Abilene & Southern Ry. Co.*, 265 U. S. 274, the order under review was based in part upon information contained in the annual reports filed by the railroad companies with the administrative agency issuing such order. Such reports were not put in evidence although the hearing Examiner announced on the record that "no doubt it will be necessary to refer to the annual

reports of all these carriers" (265 U. S. 287). The Rules of Practice of such agency also provided, "The Commission will take notice of items in tariffs and annual or other periodical reports of carriers properly on file with it or in annual, statistical, or other official reports of the Commission" (265 U. S. 287, note 12). Notwithstanding the liberal rules of practice of the agency and the aforesaid statement of the Examiner, this Court invalidated the order, holding (265 U. S. 274, 289):

> The objection to the use of the data contained in the annual reports is not lack of authenticity or untrustworthiness. It is that the carriers were left without notice of the evidence with which they were, in fact, confronted, as later disclosed by the finding made.

In *Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio,* 301 U. S. 292, a proceeding to revise rate schedules and to determine the value of properties for rate-making purposes, this Court held improper, as a denial of due process, an order of a state commission based on information not introduced in the record. In so holding, this Court said (301 U. S. 292, 300):

> The fundamentals of a trial were denied to the appellant when rates previously collected were ordered to be refunded upon the strength of evidential facts not spread upon the record.
>
> The Commission had given notice that the value of the property would be fixed as of a date certain. * * * Without warning or even the hint of warning that the case would be considered or determined upon any other basis than the evidence submitted, the Commission cut down the values for the years after the date certain upon the strength of information secretly collected and never yet disclosed.

In *West Ohio Gas Co. v. Public Utilities Commission,* 294 U. S. 63, the Commission, without notice to the company, based its final decision, in part, on certain annual reports of the Company which the Commission used in allocating costs. This Court held (294 U. S. 63, 70):

> We do not now decide that there would be a denial of due process through the spread of distributing costs over the total area of service, if the new method of allocation had been adopted after timely notice to the company and then consistently applied. * * * But the weakness of the case for the appellee is that the fundamentals of a fair hearing were not conceded to the company. Opportunity did not exist to supplement or explain the annual reports as to the distribution of the expenses in the neighboring communities, nor did opportunity exist to bring the rates outside of Lima into harmony with the exigencies of a new method of allocation adopted without warning.

In *Morgan v. United States,* 304 U. S. 1, the Court had under consideration the validity of an order of the Secretary of Agriculture fixing the maximum rates to be charged by market agencies at the Kansas City stockyards. The Court found (304 U. S. 1, 17):

> No opportunity was afforded to appellants for the examination of the findings thus prepared in the Bureau of Animal Industry until they were served with the order. Appellants sought a rehearing by the Secretary, but their application was denied on July 6, 1933, and these suits followed.

In holding that the order was "fatally defective," this Court said (304 U. S. 1, 18):

> But a "full hearing"—a fair and open hearing—requires more than that. The right to a hearing embraces not only the right to present evidence, but also a reasonable opportunity to know the claims of

> the opposing party and to meet them. The right to submit argument implies that opportunity; otherwise the right may be but a barren one. *Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard upon its proposals before it issues its final command.* (Emphasis added.)

In another very recent (1955) decision, this Court was again called upon to determine whether a party appearing before an administrative agency had been accorded a fair hearing. In *Simmons v. United States,* 348 U. S. 397, the Court, in accordance with a prior decision, held that a person seeking military service exemption as a conscientious objector must be furnished a fair resume of the report of the investigating agency. In holding that the failure to advise the party of the evidence contained in the report makes a fair hearing impossible, this Court said (348 U. S. 397, 405-406):

> We are endeavoring to apply a procedure, set forth by Congress, in accordance with the statutory plan and the concepts of basic fairness which underlie all our legislation. We have held that to meet its duty under §6(j) the Department must furnish the registrant with a fair resume of the FBI report. It is clear in the circumstances of this case that it has failed to do so, and that petitioner has thereby been deprived of an opportunity to answer the charges against him. *This is not an incidental infringement of technical rights.* Petitioner has been deprived of the fair hearing *required by the Act,* a fundamental safeguard, and he need not specify the precise manner in which he would have used this right—and how such use would have aided his cause—in order to complain of the deprivation. (Emphasis added.)

The fair hearing to be accorded parties appearing before an administrative tribunal, in accordance with the statutory plan set forth by Congress in the Administrative Procedure Act, §7(d), also requires that the evidence to be used by the agency be made available to the parties so that they may have an opportunity to answer it.

It is respectfully submitted that the decision of the court below directly conflicts in principle with the aforesaid decisions of this Court. For this reason alone certiorari should be granted.

The court below has so far sanctioned a departure from accepted statutory and judicial standards of due process of law as to call for an exercise of this Court's power of supervision.

The decision of the Court of Appeals in this case, affirming the order of the Federal Power Commission, constitutes such an alarming departure from, and disregard for, accepted statutory and judicial standards of due process of law as to require this Court, in the proper supervision of the federal judiciary, to set the lower court aright.[23] The court's persistent, albeit silent, refusal to recognize the mandatory provisions of the Administrative Procedure Act, §7(d), even after the filing of petitions for rehearing stressing the applicability of such section, sanctions a subtle erosion of legal principles so recently codified and enacted into statutory law. The decision opens the door to a resumption of the abuses and excesses indulged in by administrative agencies prior to the passage of the Administrative Procedure Act. The court's failure to curb Commission abuse of the power

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23 Supreme Court Rule 19(1)(b), 28 U. S. C. See also, **Gibson v. Lockheed Aircraft Service**, 350 U. S. 356.

to conduct hearings and decide issues on the evidence presented has placed a premium on expediency and facility of decision at the sacrifice of commonly accepted notions of a fair hearing, wherein the parties are apprised of the evidence upon which the final decision is rendered.

The ever-increasing use of administrative hearings as a vehicle for determining the rights and actions of litigant parties accentuates the impropriety of the decision arrived at by the lower court. A review of such decision by this Court is now the only means whereby the will of Congress—so clearly expressed in the provisions of the Administrative Procedure Act—that all persons appearing before administrative agencies shall be accorded due process of law, can be fulfilled.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 15,412.

Interstate Power Company,
Northern States Power Company,
Western States Utilities Company,
Minnesota Valley Natural Gas Company,
North Central Public Service Company,
Kansas City Power and Light Company
(Peoples Gas and Electric Division),
Minneapolis Gas Company,
State of Minnesota,
City of St. Paul, Minnesota, and
City of Minneapolis, Minnesota,
Petitioners,

vs.

Federal Power Commission,
Respondent.

No. 15,424.

Northern Natural Gas Company, a Corporation,
Petitioner,

vs.

Federal Power Commission,
Respondent.

Petitions to Review, Set Aside and Reverse an Order of the Federal Power Commission.

[July 9, 1956]

P. L. Farnand (G. T. Mullin and John F. Bonner were with him on the brief), for Petitioner, Minneapolis Gas Company.

F. Vinson Roach (Lawrence I. Shaw, Patrick J. McCarthy, Richard J. Connor, and George J. Meiburger were with him on the brief), for Petitioner, Northern Natural Gas Company.

Carl W. Cummins for Petitioner, Northern States Power Company.

William R. Duff (John W. Scott, Robert W. Perdue and Norman H. Nitzkowski were with him on the brief), for Petitioner, Minnesota Valley Natural Gas Company.

Clement F. Springer and Francis T. Crowe for Petitioner, Interstate Power Company; Ned Willis for Petitioner, North Central Public Service Company; Irving Fane, Arthur J. Doyle and Kyle D. Williams for Petitioner, Kansas City Power & Light Company (Peoples' Gas & Electric Division); Henry M. Gallagher for Petitioner, Western States Utilities Company; Miles Lord, Attorney General, and Joseph J. Bright, Assistant Attorney General, for Petitioner, State of Minnesota; Marshall Hurley for Petitioner, City of St. Paul, Minnesota, and Charles A. Sawyer for Petitioner, City of Minneapolis, Minnesota, were on the briefs.

W. Russell Gorman, Attorney, Federal Power Commission (Willard W. Gatchell, General Counsel, and Lambert McAllister, Assistant General Counsel, Federal Power Commission, were with him on the brief), for Respondent, Federal Power Commission.

Lloyd J. Marti for Intervenor, Central Electric & Gas Company (Raymond A. Smith for Intervenor, Council Bluffs Gas Company; Hubert C. Jones for Intervenor, Iowa Power and Light Company; and George C. Pardee for Intervenor, Metropolitan Utilities District of Omaha, were with him on the brief), for Intervenors.

Before SANBORN, WOODROUGH and JOHNSEN, Circuit Judges.

WOODROUGH, Circuit Judge.

Northern Natural Gas Company, seven of its customers located in the northern part of its service area, the State of Minnesota, and its Twin Cities, St. Paul and Minneapolis, are petitioners in these consolidated cases and they seek review under Section 19 (b) of the Natural Gas Act, 52 St. 821, 831, 15 U.S.C., Section 717, 717r(b), of the Federal Power Commission's Order accompanying and based upon its Opinion No. 281 in Docket G-2217, issued May 20, 1955, finding the collection of uniform rates and charges by Northern Natural Gas Company, a natural gas company under the Natural Gas Act, to be unjust, unreasonable, unduly discriminatory and preferential, and ordering Northern to file revisions of its F.P.C. Gas Tariff.

The proceedings before the Commission followed upon Northern's filing revised tariff sheets with the Commission on June 6, 1953, providing for increases in its rates uniformly charged to all of its resale customers except in the Argus system. The Commission commenced a hearing and temporarily suspended such increase tariff sheets by Order dated July 24, 1953. Numerous customers of Northern

were permitted to intervene in the proceedings and two of these customers, Council Bluffs Gas Company and Central Electric and Gas Company, complained in their petitions that, as they were located closer to the supply of natural gas, Northern's system of charging uniform rates was unduly discriminatory as to them and that it was unduly preferential to others farther removed from the source, and they requested that the Commission establish service zones and differentials in rates in divisions of Northern's service area to eliminate the discrimination and preference.

Hearings were begun before a Trial Examiner, but on January 21, 1953, agreement was reached by all parties to the proceedings with respect to the increases in rates and charges to be made immediately effective on Northern's system. The issue however as to establishing service zones and differentials in rates in different zones as requested by the said customers was not agreed to but was deferred by stipulation for later hearing and determination. The stipulation included the following:

"It is agreed that this settlement will dispose of all matters involved and issues presented in this proceeding, excepting the single issue respecting zones of service and differentials in rates between zones. It is further agreed that further hearings herein respecting such issue shall be had at the earliest practicable date and the cost of service hereinbefore set forth and agreed upon for the purposes of this settlement shall be used to the extent that cost of service is involved.

"For the purposes of this settlement it is further agreed that the decision of the Commission respecting such issue of service zones and rate differentials, if it requires a change in the revised rate schedules filed pur-

suant to Section 1 hereof, shall not be made effective prior to December 27, 1954, nor result in revenues less than the agreed cost of service. It is also agreed that, if so required by decision of the Commission on further hearings herein, Northern shall incorporate in revised rate schedules filed to become effective on or after December 27, 1954, the methods and principles found by the Commission, subject to the judicial review, to be proper as to zone and rate differentials with due regard to the recovery of reasonable cost of service."

On January 28, 1954, the Commission issued an Order approving the stipulation and requiring Northern to file tariff revisions in accordance with it. The Order also provided that "the record in this proceeding shall remain open for further hearings to be held commencing March 22, 1954, * * * respecting the single remaining issue concerning service zones and differentials in rates in areas served by Northern."

Northern filed the required tariff revisions and the hearing in respect to zoning and differentials in rates was in due course convened before the Presiding Examiner. Northern's three customers, Central Electric and Gas Company, Council Bluffs Gas Company and Metropolitan Utilities District of Omaha, located in the intermediate area of Northern's service, called witnesses, introduced evidence and argued as Proponents of zoning and rate differentials, and all of the other intervenors participating in the proceeding and Northern joined in presenting evidence and argument in opposition thereto.

The Presiding Examiner issued decision on November 18, 1954, after extended hearings and submission of briefs, finding that Northern's existing uniform rate was

not unduly discriminatory or preferential, and that the "public interest does not now require establishment of service zones or zone rates."

Exceptions were filed to the Decision by the three proponent companies and by counsel for the Commission's staff to which Northern and other opponents of zoning answered, and the Commission, sitting en banc, heard oral argument on the exceptions and answers.

On May 20, 1955, the Commission issued Opinion No. 281 and accompanying Order by which it found that the use of system wide rates by Northern is unduly discriminatory and preferential and directed Northern to divide its system into three zones with a different rate for each zone.

Northern's pipe-line transmission system is about 800 miles in length, extending from the Panhandle Field in Texas and the Hugoton Field in Kansas and Oklahoma to a point near the Twin Cities of St. Paul and Minneapolis and is, at its maximum, approximately 300 miles in width. In addition to the gas purchased from producers in these fields, Northern also takes delivery of substantial volumes of gas near Wasson, Texas, from Permian Basin Pipeline Company, a subsidiary of Northern. Permian in turn purchases natural gas in the Permian Basin area in west Texas and eastern New Mexico, some 400 miles south of the other gas fields supplying Northern. Thus Northern's system is, in that aspect, extended to a distance of about 1,200 miles.

Natural gas transported through this system is sold to other utilities at points in Kansas, Nebraska, Iowa, South Dakota, and Minnesota for resale to consumers in these states. Deliveries to these distribution company

customers of Northern are effected at many widely scattered points requiring the transmission of the gas through Northern's system for varying distances ranging from 179 miles to 803 miles from the source of gas supply.

Northern serves one distributing company in the State of Kansas, the Kansas Power and Light Company. Deliveries to this customer are made at 15 separate points requiring transmission through Northern's facilities of distances ranging from 179 to 322 miles from the source of gas supply. Northern serves 26 other utilities in the States of Nebraska, Iowa, South Dakota, and Minnesota. Sales to these customers for resale are made at 126 points on Northern's system ranging from 390 to 803 miles along the system.

Zone 1, as prescribed by the Commission, embraces all sales requiring transmission of gas for a distance of 191 miles beyond Bushton, Kansas, and also includes all sales made south of Bushton. Zone 2 embraces all sales made on the east and west legs of Northern's main transmission line up to approximately 190 miles beyond Zone 1. Zone 3 includes all sales requiring transmission of approximately 180 miles on the west, and 183 miles on the east legs of the main transmission line beyond the northern boundary of Zone 2.

The Commission ordered Northern to file revised rate schedules to be effective as of June 27, 1955, (originally May 27, 1955) providing for a two cents per Mcf differential in average revenue for sales in each zone with the lowest rate in Zone 1 and the highest in Zone 3. This was stated to be "only an interim rate subject to subsequent adjustment and possible refund."

The Commission was unanimous:

1. In finding that Northern's uniform rates were unduly discriminatory;

2. In finding that the establishment of zones with proper differentials in the rates was necessary to eliminate this discrimination;

3. In establishing the three zones and fixing their boundaries;

4. In finding the differential in average cost of service between zones 2 and 3 to be 3.06 per Mcf.

The majority opinion concluded that a differential in rates between zones of only 2 cents per Mcf should be made effective "at this time on an interim basis, subject to subsequent adjustment and possible refund." Two of the Commissioners dissented from the Opinion on the ground that the indicated cost differential was shown to be 3.06 cents per Mcf from zone to zone and that an initial rate differential of 2½ cents per Mcf "would be more equitable," even if it be recognized that "some softening of the impact may be appropriate."

Applications for rehearing were filed with the Commission by Northern and by those customers who are the petitioners here in No. 15,412 and were denied, and the filing of the instant petitions for review in this Court followed. Meanwhile, Northern, as required by the Commission's Order accompanying Opinion No. 281, has filed revised rate schedules to reflect the service zones and zone rate differentials. This Court has subsequently accorded a partial stay of the Order.

Section 4(b) of the Act, 15 U. S. C. A. 717c(b), prohibits any natural gas company from making or granting any undue preference or advantage to any person, or sub-

jecting any person to any undue prejudice or disadvantage with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, and Section 5(a), 15 U. S. C. A. 717d(a), empowers and requires the Commission to determine the just and reasonable rate, charge or practice to be observed by a natural gas company and to fix the same by order.

Section 5(a) also contains a Proviso "That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission unless such increase is in accordance with a new schedule filed by such natural gas company."

The opponents of zoning contended before the Trial Examiner and before the Commission, and now insist here, that the Proviso of 5(a) deprives the Commission of power to cause Northern to charge any higher rate in any zone it might set up than was shown for the same area in the currently effective schedule for the same area. They take the position that the establishment of zones and differentials in rates involved an increasing of rates in zone 3 beyond the rate for the same area contained in the currently effective schedule of the natural gas company; and that the Commission was accordingly without jurisdiction and there should be dismissal for want of jurisdiction.[1]

The Commission in reply to this contention pointed in its Opinion to the positive duty imposed upon it by the

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1 Appended to Joint Reply brief of nine petitioners is copy of excerpts from brief filed in Matter of Atlantic Seaboard Corporation, Docket Nos. G-1384 and G-1175 (pp. 3-11), giving legislative history and judicial discussions of Proviso 5(a). Also excerpts from brief in same matter by Lynchburg Gas Transmission Corporation.

statute to determine just and reasonable rate charges and practices and to prevent any undue discrimination with respect to the sale of natural gas, and it observed:

"Undue discrimination or preference, as found to exist by reason of the present rate practice of Northern, may be eliminated in several ways, of which an increase in rates for certain service is only one. Section 5(a) specifically provides also that 'the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, or otherwise unlawful, or are not the lowest reasonable rates.' It would also be quite proper for the Commission, upon the finding of undue discrimination or preference under the facts of this case, to determine appropriate zones of service and require Northern to file appropriate rates which would not be unduly discriminatory or preferential. [*Federal Power Commission, et al. v. Natural Gas Pipeline Company, et al.*, 315 U. S. 575, 583-585.] And the Commission may, as we do here, in the circumstances of a particular case merely determine and fix the differential in rates that is reasonable and necessary to eliminate existing unlawful discrimination and preference, leaving to the company the decision as to how such differential shall be incorporated into its rate schedules. As the Supreme Court has said [Id. p. 586]:

" 'The constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.' "

The record herein shows that these present proceedings before the Commission were initiated by Northern. Northern filed its revised tariff sheets calling for higher rates on June 6, 1953. But the higher rates called for were uniform rates for the system and there was the answering claim of the proponents of zoning and rate

differentials that the uniform rates of those tariff sheets unduly discriminated against them and that the discrimination should be eliminated by zoning and rate differentials. The Commission manifestly became possessed of jurisdiction of the whole of the controversy as to the raising of its rates and as to discrimination therein, and, although agreement was arrived at by the parties concerning uniform interim rates to be charged, the record in the proceeding was kept open so as to retain for the Commission's determination the duly presented issue of undue discrimination and removal thereof by fixing zones and differentials. Such retention of the issue by the Commission was a part of the agreement of the parties and was included in the approval of the agreement by the Commission. Nothing occurred to divest the Commission of the jurisdiction conferred upon it to decide and act upon the whole issue presented to it.

The Commission's conclusion that it had jurisdiction is strengthened by the decision of the Supreme Court in *United Gas Co. v. Mobile Gas Corp.*, 350 U. S. 332. The Court there declares that "the basic power of the Commission is that given it by Section 5(a) to set aside any rate which it determines after hearing to be * * * unduly discriminatory or preferential. * * * Section 5(a) authorizes the Commission to investigate rates not only 'upon complaint of any State, municipality, State Commission or gas distributing company,' but also 'upon its own motion.' Thus while natural gas companies are understandably not given the same explicit standing to complain of their own contracts as are those who represent the public interest or those who might be discriminated against, there is nothing to prevent them from furnishing to the Commission any relevant information and requesting it to initiate an investigation on its own motion. And

if the Commission after hearing, determines the contract rate [of a natural gas company] to be so low as to conflict with the public interest, it may, under Section 5(a), authorize the natural gas company to file a schedule increasing the rate."

So, in this case, if Northern's uniform rate was, as alleged, unduly discriminatory, and if it was necessary or appropriate for the Commission to establish zones and differentials in order to eliminate such discrimination, nothing contained in the Proviso of 5(a) restricted the Commission's power to do so. The Commission would not be violating the Proviso of 5(a) by ordering Northern to reduce its existing rates in Zone 2 and authorizing it to increase its existing rates in Zone 3, through the use of an approved differential, in order to balance its revenues. This is what we construe the effect of the Commission's decision and order to be.

The revised tariff filed by Northern on July 2, 1954, was accepted by the Commission as compliance with the requirements of Opinion 281 and Order. It was made effective for an interim period pending final decision by the Commission after hearing in Docket No. G-2505 as to the just and reasonable charges Northern should be permitted to demand and collect in connection with new tariff sheets raising rates filed by it. Such new tariff sheets were filed by Northern on July 2, 1954, designed to increase its revenues from jurisdictional sales $8,128,405 annually over the revenues estimated to be produced by the schedule made effective pursuant to the approved settlement in Docket No. G-2217 proceeding. The zone rates and charges were made subject to refund by Northern of such portion thereof as might be subsequently ordered by the Commission after further proceedings in Docket No.

G-2505, including hearings. There is and can be no question that the Commission was given the power under the Act to determine whether or not a natural gas company's uniform rates are unduly discriminatory, and it is equally clear that where such discrimination is found to exist, the Commission was empowered to eliminate it by establishing zoning and rate differentials.

We hold that the Commission regularly acquired and retained jurisdiction in respect to zoning and resulting rate differentials for Northern Natural Gas Company in this case.

The grounds upon which the petitioners seek reversal of the Commission's Opinion No. 281 and Order, additional to the matter of the Proviso of 5(a), are stated in somewhat different forms in their several briefs, and without reiterating the characterizations of alleged errors as "arbitrary," "capricious," "abuse of discretion," "contrary to law," etc., we epitomize those contentions meriting discussion as follows:

Petitioners contend:

1. That the finding that the distance Northern transmits the gas it sells is the controlling factor in determining its costs of transmission so that its charging uniform rates throughout its service area (excepting the Argus area) was unduly discriminatory and preferential was not based on and is not supported by substantial evidence;

2. That the zone lines have been fixed without substantial evidence and upon evidence outside the record;

3. That the Commission erred in establishing the zones upon consideration of evidence not shown in the record in respect to new construction authorized in Docket No. G-2063 and without determining costs of the new construction;

4. That the Commission erred in establishing lines of the zones without giving petitioners a hearing upon a proposal to establish the particular lines fixed;

5. That there was no evidence of changed conditions justifying departure from the Commission's approval of Northern's uniform rates. *Colorado Interstate Co. v. Commission,* 324 U. S. 581;

6. That the Commission erroneously failed to find as shown by the evidence that increased rate in Zone 3 is likely to price gas out of the industrial market in that area.

1. *Claimed insufficiency of the evidence.*

The Commission declared the basic question for its decision in the proceeding was "whether the present rate structure of Northern is unduly discriminatory or preferential" in contravention of Section 4(b), 15 U. S. C. A. 717c(b), which provides "No natural gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage * * *." And havng considered the question and evidence bearing on it, the Commission stated:

"The matter now before us involves a determination as to whether unlawful discrimination or preference is created by the exaction from all customers on a transmission system of identical, uniform rates when the points of delivery to the several customers are as much as 600 miles apart. We find, under the circumstances of this case, that Northern's uniformly applicable rates and charges are unduly discriminatory as to some of its customers and unlawfully preferential as to others."

The Commission included the declaration in its opinion that "it is a simple economic fact that the delivery

cost of natural gas increases in close proportion to the length of the transmission line of any given size" and it adverted in that connection to the fact in evidence that "transmission expense amounting to $50,500,000 constitutes 55 per cent of Northern's total cost of service and 96 per cent of the total for items other than gas production expense." Inasmuch as natural gas can only be moved through the pipe by application to it of force that costs money to apply, there has been no attempt to dispute "the simple economic fact" of the Commission's finding where one sized pipe is used. The cost per Mcf is less where larger pipe is used and kept filled under greater constant pressure.

The Commission further declared:

"* * * unless other circumstances are present which outweigh the importance of the length of transmission required to effect delivery, the distance factor is the prime determinant of the cost of rendering service. Since in our view of this record there are no such circumstances present to counterbalance the distance factor, we conclude that the distance of transmission required to effect deliveries at the various points of sale by Northern reflects with reasonable accuracy the relative cost of providing service to its customers. We further find and conclude that Northern's present practice of demanding and collecting uniform rate throughout the length and breadth of its area of service for the sale of natural gas for resale is unjust, unreasonable, unduly discriminatory and preferential. This practice results in the shifting of transmission cost from those whose service requires its incurrence by reason of the greater transportation distances to others who are not responsible for such cost—and who are not benefited correspondingly."

In reaching its determination that there were no other circumstances present to counterbalance the distance factor, the Commission gave consideration to the

cost of service agreed upon in the stipulation and to (a) the distribution of sales along the route of Northern's system and the volume of gas sold; (b) the load factor of such sales; and (c) the comparative benefits to customers situated in the upper and lower reaches of the principal market area derived from the lowered unit cost resulting from the large volumes of gas transmitted through the system.

(a) As to distribution of sales, the Commission found that, although there are 126 points at which jurisdictional sales and deliveries are effected in the area north of the Kansas-Nebraska boundary, wherein 99.65 per cent of the total estimated jurisdictional sales were made, sales at 8 principal points represented over 71 per cent of Northern's total estimated jurisdictional sales in 1954. The facts concerning deliveries at these points are shown in the following tabulation:

Delivery Point	Estimated Annual Sales 1954 (Mcf)	Percentage of Total Annual Jurisdictional Sales	Percentage Load Factor of Sales	Weighted Average Miles of Haul Transmission System
Lincoln	10,866,200	4.63	76.19	447.62
Omaha	26,345,000	11.23	78.27	480.61
Co. Bluffs	6,053,600	2.58	77.02	483.96
Sioux City	9,826,400	4.19	75.87	560.46
Des Moines	25,352,400	10.81	81.75	625.91
Sioux Falls	7,358,800	3.14	81.10	642.92
Minneapolis	55,013,000	23.45	70.30	795.59
St. Paul	25,922,200	11.05	83.27	803.37
Total	166,737,600	71.08	76.41 Ave.	666.65 Ave.
Jurisdictional Sales System Total	234,588,200	100.00	76.39 Ave.	662.00 Ave.

The record also shows for each other point of delivery by Northern the amount of gas delivered annually, the volume of gas delivered during the period of peak demands, and the miles of transmission required to effect delivery at such points of deliveries. It was fairly inferable from that evidence that there is no such concentration of sales in a single area as would countervail against the factor of distance, the mileage of haul, and the Commission so found. The Commission further found that "While it is true that 37.5 per cent of the total estimated jurisdictional sales for 1954 were made at or near the terminus of Northern's system, the distribution of the remainder of these sales along the system is such as to foreclose a finding that sales at the farthest points of the system are so predominate as to be of controlling consideration rather than the distance factor." This finding of the Commission is supported by the following tabulation in the Opinion No. 281 showing the distribution of jurisdictional sales along the length of Northern's system, and is corroborated by the extensive detailed evidence respecting each and every point of delivery.

Distance in Miles From Source of Gas Supply	Estimated Jurisdictional Sales for Year 1954 (Mcf)	Percentage of Total Jurisdictional Sales
0-400	1,826,400	0.778
401-500	47,520,800	20.257
501-600	20,025,500	8.537
601-700	61,954,900	26.410
701-803	103,260,600	44.018

(b) Turning to a consideration of the load factor of jurisdictional sales on the system, the Commission found that the load factor of sales in the State of Minnesota, the most remote from the source of gas supply, was the lowest of any state served by Northern and lower than the

system average. The annual load factor of jurisdictional sales in Minnsota was 73.80 per cent.[2] In other states it ranged from 76.92 per cent to 80.74 per cent, with a system average of 76.38 per cent. Load factor as here used reflects the relationship between average daily deliveries and the deliveries in the peak period. The matter of load factor is of importance because, for any given length and size of transmission line, delivery cost per Mcf increases as the load factor at which the line is operated decreases. As the Commission pointed out: "This generality simply gives expression to the mathematical fact that more complete utilization of any given capital facilities involving fixed costs will result in declining unit costs."[3] Therefore, as the Commission properly found, the lower load factor of sales in the State of Minnesota tended to depress the load factor of the system and thus contributed to a higher unit cost for all gas delivered from the system.

(c) As to the comparative benefits, the Commission had before it the testimony of expert witnesses presented by the customer Proponents of zones and rate differentials and by the Commission's staff. The witness presented by the Proponents, Mr. N. Knowles Davis, has been the Chief Engineer of the Georgia Public Service Commission for about twenty years and sometimes serves as a private consultant, as in this proceeding. It was Mr. Davis' opinion that, if the total cost of service of a natural-gas pipe-line system is to be equitably distributed among the customers of the system, it is essential that

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2. The load factor of sales in Minneapolis, the largest single customer was the lowest of the group of major markets.

3 Citing "F. P. C. Docket No. G-580, Natural Gas Investigation, Smith-Wimberly Report, page 260; Hamilton Cost as a Standard for Price, 4 Law and Cont. Prob. 321, 330."

recognition be given to the cost of service by rate zones; that to have a flat demand and commodity rate uniformly applicable throughout the length of a long pipe line results in discrimination; that customers located in a zone nearer the source of gas supply should not contribute to a rate of return on plant facilities which are in no way used to furnish service to the zone in which they are located; and that the principle of cost allocation by rate zones and the establishment of rates based on such cost allocation is sound and logical and equitable to all concerned.

This witness also expressed the opinion that cost of service varies with the distance transported; and that recognition of this variable cost of service with distance requires zone rates for the transportation of natural gas if equitable charges for the service are to be applied.

With particular reference to the system of Northern, Mr. Davis expressed the following opinions, which were arrived at after a detailed study of the system and operations of the company:

"In the first place, the Northern Natural System extends between eight and nine hundred miles geographically from the source of its supply to its terminus.

"In the second place, the line does not alone serve a single primary area at or near its terminus. This is not a case where the pipeline extends from its source of supply to a single market at its terminus.

"In my opinion a line of this length with a market distributed as it is along this line requires the establishment of rate zones and zone rates in order to equitably distribute the total cost of its service among its market customers.

"In my opinion zone rates are required by reason of the length of a line and the distribution of deliveries

along a line. When you have a relatively long line and substantial market areas at considerable distance from one another, it becomes essential, in my view, to provide zone rates in order to eliminate what seems to me to be unreasonable discrimination."

This witness was of opinion that, although capacity of the line enters into it and to quite an extent the distribution of the load along the line, the length of the line is more important than any other factor.

The expert witness presented by the Commission's staff, Mr. Joseph J. Curry, also expressed the opinion that the then existing rate structure of Northern providing uniform rates throughout the system was inequitable, and that the establishment of service zones and zone rate differentials on a proper basis would result in a more equitable distribution and assessment of the transmission cost of service. In the opinion of this witness the fixing of service zones with proper rate differentials was required to give recognition to the miles of haul required in rendering service to the various customers of Northern.

The record also shows that the Commission gave due consideration to the evidence against zoning. It weighed the testimony of witnesses called by the petitioners herein and their studies of Northern, its history, operations and customer relations. The Commission also had before it and considered the carefully prepared decision of the informed Trial Examiner as well as the briefs and arguments of the opponents of zoning. We also have considered the same, and we are satisfied that there is substantial evidence supporting the findings and conclusions of the Commission that Northern's uniform rate structure subjects some of its customers to undue discrimination

and is unduly preferential to others. Even though a different conclusion could have been drawn, as it was by the Trial Examiner, it cannot be held that the Commission was plainly in error. Section 19(b) of the Natural Gas Act makes such findings conclusive when they are so supported, 15 U. S. C. A. 717r(b), and they should be affirmed. *Colorado Interstate Gas Company v. Federal Power Commission,* 8th Cir., 142 F. 2d 943, 961, affirmed, 324 U. S. 581.

2. *As to the zone lines fixed by the Commission.*

The Commission found on study of the plans for zoning that were proposed by the expert witnesses and explained by testimony that, although each tended to eliminate some discrimination resulting from Northern's uniform rate, each left certain unjust inequalities. The zone plan referred to as Staff Proposal B, which was urged as most appropriate for adoption by the Staff, is basically the same as that decided on by the Commission except that the Commission, on closer study, found instances where sales at some points near the proposed zone border line would be made at the lower rate, although actually requiring transmission through main and lateral line facilities for a greater total distance than some other sales to be made at a higher zone rate. The principal difference between the Staff's recommended zoning and that fixed by the Commission is found in the areas in the vicinity of Beatrice, Paullina and Ogden compressor stations. In these areas where the Staff proposed that the zone boundaries be fixed at the compressor stations, the Commission modified the zone boundaries to include sales immediately beyond and in the vicinity of the stations. The Commission simply brought the zones in a little closer conformity to its finding that the distance of the

haul was the controlling factor in determining cost of transmission.

As noted above, it was a part of the Commission approved agreement that Northern should incorporate in revised rate schedules filed to become effective on or after December 27, 1954, "the method and principles found by the Commission, subject to judicial review, to be proper as to zone and rate differentials with due regard to the reasonable cost of service." But when Northern filed its new schedules for increased rates and charges on July 2, 1954, which were first suspended but later made effective as of December 27, 1954, subject to refund, the Commission had not issued its Opinion and Order as to zones and differentials, and when it did issue them on May 20, 1955, Northern's new rates had become (conditionally) effective upon a uniform basis.

Accordingly, the Commission undertook to determine by cost allocation principles, referred to in the Opinion, what the rates for the zones would be if computed on the full cost of service claimed by Northern. As so computed, the rates indicated that the differential would be 3.06 cents per Mcf. But the Commission did not impose that differential. It ordered the revised schedules to reflect a differential between zones of "approximately 2.00 cents per Mcf."

We think that the Commission made no more use of the record evidence it found furnished by Northern in Docket G-2505 and Docket G-2063 (outside of this G-2217 record) than to verify certain mathematically computed measurements of distances and to assure itself that the zone differential it prescribed (subject to reconsideration and refund in the pending Docket G-2505 proceeding) was

substantially less as appears without dispute than would be shown on the hearing.

We find therefore that the use the Commission made of Northern's record evidence in Docket G-2505 that was not included in the hearing of these proceedings of Docket G-2217 was not the basis of its determination of discrimination and to the extent that that evidence influenced the rate differential arrived at, it tended to and was used to reduce the amount thereof and did not prejudice the petitioners. There was no denial of due process.

3. *As to new construction.*

The record shows that at the time of the hearing before the Examiner, March through June, 1954, Northern had commenced construction of lateral lines to some 60 or 70 new jurisdictional sales communities, such service having been authorized by Commission Opinion and Order No. 268 issued March 11, 1954, Docket G-2063. These laterals were completed by December 27, 1954, after the hearing before the Examiner herein was terminated and his decision issued. The new construction cost about $14,000,000 and the new sales and related revenues estimated increased investment and were reported to the Commission by Northern in connection with its filing of new schedules for increased (uniform) rates and charges on July 2, 1954, above referred to. The Commission suspended the schedules but they were made effective and uniform rates were collected under them as of December 27, 1954, subject to refund.

As set forth above, it was part of the Commission approved stipulation for settlement that Northern should incorporate in its new schedules, which were to become effective December 27, 1954, "the methods and principles

found by the Commission, subject to judicial review, to be proper as to zone and rate differentials with due regard to the recovery of reasonable cost of service."

In view of the new construction and the new rate filings, the Commission did not attempt to hold Northern to the precise terms of the stipulation or the computations that were submitted with it. But it is clear on the record that, if it should appear in the impending hearings in the proceeding in Docket G-2505 that the differentials ought to be less than 2.00 cents per Mcf prescribed or that an excessive rate is being or has been collected, the opportunity is there presented for the Commission to make adjustment and require refunds. The present rates of Northern are effective at this time on an interim basis. We find no impediment to the decision or justification for reversal of its Opinion in the fact that there was this new construction going on during the hearings and completed afterwards. There is no reason to infer that the new construction changed the basic conclusions upon which the Commission acted.

4. *As to the lack of hearing on the particular zone lines prescribed.*

The Commission observed:

"In theory, the ideal non-discriminatory, and non-preferential rate structure would be one designed to assess each point of sale and delivery with the total of the various cost components incurred in the rendering of service to each point. But any attempt to arrive at such perfection would not only be delusory, [*Colorado Interstate Gas Company v. Federal Power Commission, et al.*, 324 U. S. 581, 589; *Hamilton, Cost as a Standard of Price*, supra (4 Law and Const. Prob. 321); (F. P. C.) Op. No. 225, *In the Matter of Atlantic Seaboard Corporation, et al.*, pp. 17-19 (mimeo. ed.)], but also impracticable and in-

feasible from both the management and regulatory point of view. In the circumstances of this case the only practical and reasonable approach to an equitable solution is the establishment of service zones—with rate differentials—as urged by the Proponents of zoning and the Staff.'"[4]

After noting the zoning proposals advanced by the Proponents of zoning, the four alternative bases for zoning proposed by the Staff, and the voluntary suggestion of the Presiding Examiner as to what he considered would be proper service zones, the Commission stated:

"After detailed consideration of the record, we have concluded that none of the zoning plans presented by the Proponents and the Staff or the modified plan which the Examiner finds most feasible are appropriate and acceptable. While each might as claimed tend to eliminate or reduce the discriminations and preferences existing under the present rates of Northern, the facts are clear that other inequities would be created by the establishment of zones according to any of these plans.

"Under each of these plans, including that found most proper by the [Presiding Examiner's] Decision, determination of the zone in which a particular sale is made would be fixed by the point on the main line from which the lateral line enabling such sales takes off. All of Northern's sales of gas for resale are effected at the city gates of the communities served. In most instances these sales are made at the terminii of lateral lines branching from the main line transmission facilities. Thus, the total distance of transmission to each point of delivery is repr-

4. In effect much of the argument of petitioners here constitutes attack upon this conclusion of the Commission. It is contended that the Commission should have had more data respecting the comparative costs of transmission to all the different areas and points of delivery in the system, but we think the Commission's declaration as to what was practical or feasible from the management and regulatory point of view is entitled to weight and may not be disregarded.

sented by the aggregate of the mileage of the transmission through both the main line and the lateral line serving each point of sale. As a result, as is elaborately pointed out by the Opponents, under each of these methods of zoning the total mileage of transmission to certain points in zones closer to the source of supply is greater than the mileage to other points of sale in zones farther removed from the source. Under each of the plans considered, including the Examiner's, deliveries to certain points requiring the greater mileage of transmission would be made at the lesser rate."

Whereupon, after noting these findings were sufficient in the Commission's view "to condemn each of these methods of zoning" advanced by the Proponents and the Staff, the Commission pointed out other additional reasons why it did not find any of such proposals wholly acceptable. After analyzing the evidence, it concluded:

"* * * that the most appropriate and practicable method would be the establishment of three zones on Northern's system with zone boundaries as depicted on the map following this page. * * * This plan, in our view, provides the most effective and equitable basis for eliminating the present unlawful discrimination and preference.

"As noted previously, the Bushton Compressor Station is the last point of input of gas into the main-line facilities. Under this plan, the service area north of the Bushton station wherein more than 99 per cent of the jurisdictional sales are made is divided into three zones which are as nearly equal as they can reasonably be so far as transmission distances are involved."

The petitioners contend that when the Commission decided to reject the several defined zones which were proposed and opposed on the hearing before the Trial Examiner, it should have given notice and held a hearing

in respect to the particular zone lines which it contemplated establishing. They argue that they were denied due process in this respect.

It cannot be denied that the course contended for would have been held appropriate if the Commission had followed it, but we do not find a denial of due process in the course that was followed. The Commission is "one of the agencies presumably equipped or informed by experience to deal with a specialized field of knowledge, whose findings within that field carry the authority of an expertness which courts do not possess." *Universal Camera Corp. v. National Labor Relations Board,* 340 U. S. 474, 488. It has been delegated by the Congress to administer the Natural Gas Act "with power to draw inferences from the facts." Its "function is not only to appraise the facts and to draw inferences from them, but also to bring to bear upon the problem an expert judgment." *United States v. Detroit & Cleveland Navigation Co.,* 326 U. S. 236, 241, and particularly its findings and directives need not be based directly on the expressed opinion of experts, but may be drawn from the facts. *Market Street R. Co. v. Commission,* 324 U. S. 548, 559, 560.

In this instance the evidence before it, taken in sixteen days of hearing and including some 2,000 pages of testimony and 46 exhibits, many of which are quite voluminous, was sufficient to enable the Commission to establish just and proper zone lines. It had to make only slight changes in the zone lines testified about by the experts. In the hearings, counsel for the Opponents brought out on cross-examination of the Staff witness concerning the Staff's proposed zones, instances where a higher rate would be charged at points near the zone boundaries although the total distance of transmission to the points of

delivery was less than to other points where the charge would be less. This inequity was eliminated by the Commission by sharply zig-zagging the zone boundary lines. There is no suggestion of any mistake or oversight in drawing the zone lines as the Commission drew them. If such should arise, it would be for consideration and correction in Docket G-2505.

The major defense to the charge that uniform rates were unduly discriminatory was that it was illogical and arbitrary to allocate transmission costs on the mileage basis alone. The petitioners contend that considerations as to volume of gas sold, size of the pipes used, the annual load factor, and competition of other fuels counterbalances the distance factor, so that costs are not in proportion to distance and the public interest is not served by zoning. But the record reflects that the Commission did not fail to consider any of these matters of defense. It had the figures in detail as to each of the factors and the opinions of experts as to the relevancy of each of them to the transmission cost.

The petitioners also insisted that several of the elements necessary to make a determination on this major issue were not shown by evidence in the record. Thus, although it was shown that there are about 2,000 miles of branch lines and 3,200 miles of main line and the pipes of the branch lines and of the main lines vary in size, there was no specific finding as to just what effect this variance had on the unit transmission cost. Petitioners presented testimony supported by exhibits tending to show the benefits in costs which consumers below Minnesota derived from the transmission and sale of gas to that area. It was also argued that new construction to serve some sixty or seventy additional communities might

affect the conclusion that distance alone was determinable of the cost of transmission.

But the conclusion arrived at by the Commission, after considering all the contentions, was that none of these factors nor all together sufficed to overcome the evidence that it was the distance which determined the relative cost of transmitting the gas to the delivery points of the system; and that the cost increased and lessened in direct proportion to the distance. That conclusion was within the province of the Commission.

5. *As to Commission's former sanctioning of uniform rates.*

The record shows that the Commission has on several occasions since the effective date of the Natural Gas Act in 1938 adverted to the matter of Northern's uniform rates, at all times consistently charged by it with Commission permission throughout the area of service (except as to the Argus system). In *Trunkline Gas Supply Company,* Opinion No. 178, Docket No. G-882, 8 F. P. C. 250 (April 29, 1949), the Commission expressly stated that:

"It is significant to note that throughout this period of expansion [1945-1949], and taking into consideration the many problems relating thereto from the standpoint of operation, costs and earning, Northern Natural has never seen fit to vary from its policy of a uniform system-wide rate structure for sale from its main line transmission system.

"Accordingly, from this present record it appears that Northern should continue its present practice of charging a uniform demand-commodity form of rate for all sale-for-resale services on its main line system after it commences its purchases of gas from Trunkline. This is

consistent with Commission's past position in that it held that 'In the absence of compelling reasons to the contrary, it is good and desirable practice to fix rates that are uniform.'"

In *State Corporation Commission of Kansas v. Federal Power Commission,* 8th Cir., 206 F. 2d 690, 713, this court agreed with the conclusion of the Commission then under review that the Proponents of zone rates for Northern had "made no record in [the] case to afford a basis for the establishment of such rates." It is also evident that the Commission Staff thought that it was settled in the *Trunkline* case that, until compelling reasons were shown to the contrary, Northern should charge uniform rates.

Petitioners' contention is to the effect that the Commission was precluded from fixing zones and differential rates for Northern.

We do not so conclude. It appears that this case presents the first instance in which the Commission has made what it has deemed to be a sufficient study of the facts to enable it to make definite and positive finding that Northern's uniform rates are in fact unduly discriminatory. In this case the Commission had available to it at the outset the cost allocations which had been considered and agreed to by all parties to the proceedings and were approved by the Commission. The situation was contrasted with that presented to this Court where conflict continued respecting the allocations. Neither the Commission nor this Court was bound in that respect to Northern's uniform rates except as the Commission was obligated to recognize and permit them unless and until it was proved by substantial evidence that they were unduly discriminatory. We do not find sufficient cause to upset that ruling of the Commission.

6. *As to pricing gas out of upper zone market.*

The Commission considered the contention that the increase of rates in zone 3 would result in the loss of industrial sales to competitive fuels, but found the evidence less than convincing. It permitted Northern, if it chooses to do so, to maintain in the rate schedules files pursuant to the Order in the instant matter a uniform commodity charge throughout the system and to adjust the demand component of the rates to provide the differential between zones of approximately 2.00 cents per Mcf at a 70 per cent load factor.

Our own consideration of the evidence concerning the effect of the zoning and differential upon competition with other fuels does not compel conclusion, on the present record, contrary to that reached by the Commission. The testimony is meager. The matter is for hearing in G-2505 and the statements concerning it in the Opinion reflect that the Commission will not arbitrarily or unfairly limit the rights of Northern or the interests of its customers in the field of competition.

On review of the whole record, we conclude that the Commission has acted in a matter within its jurisdiction; that its findings are supported by substantial evidence and are not contrary to the evidence; that the conclusions are not contrary to law or erroneous; and that the Opinion and Order should be sustained. The points raised and argued in the briefs have been considered, though discussion of some is deemed unnecessary. The Opinion and Order are

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX B

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION,

Opinion No. 281

In the Matter of
Northern Natural Gas Company

Docket No. G-2217

Adopted: May 19, 1955

Issued: May 20, 1955

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

In the Matter of
Northern Natural Gas Company

Docket No. G-2217

OPINION NO. 281

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Claude L. Draper, Nelson Lee Smith, Seaborn L. Digby and Frederick Stueck.

In the Matter of
Northern Natural Gas Company

Docket No. G-2217

OPINION NO. 281

OPINION AND ORDER PRESCRIBING RATE ZONES AND RATE DIFFERENTIALS

This matter is before us upon exceptions to and appeals from the Intermediate Decision of the Presiding Examiner as filed herein on November 12, 1954. There is to be decided a single issue presented by the proposals of certain intervening parties that service zones be established on the system of Northern Natural Gas Company (Northern) and that differentials in rates be fixed for service in such zones.

The proceeding arose out of the filing on June 26, 1953, by Northern of proposed revised sheets to its FPC Gas Tariff to provide increases in rates and charges for the sale of natural gas for resale. By order issued on July 24, 1953, pursuant to Section 4 of the Natural Gas Act, the Commission, upon its own motion, suspended and deferred the use of such proposed revised sheets.

Pursuant to Commission order, hearings were held on October 26, 27, and 28, 1953, at which Northern presented evidence purporting to support its proposed increased rates and charges. Thereafter, on January 21, 1954, following conferences among the parties to the proceeding, final agreement was reached by the parties respecting

all matters involved and issues presented in the proceeding excepting the single issue respecting rate zones and rate differentials.

The agreement of the parties was reflected in a statement approved by the Commission by order issued January 28, 1954, which required Northern to file revisions of its FPC Gas Tariff to accord with the approved settlement. This order, as contemplated by the approved settlement, also directed that further hearing be held in this proceeding respecting service zones and differentials in rates.

Pursuant to such order issued January 28, 1954, hearings on the issue now before us were held commencing on March 22, 1954, and, with necessary recesses thereof, concluded on June 24, 1954. A large number of parties were permitted to intervene and participate in the proceedings. Their identity is disclosed at a further point herein.

The Presiding Examiner filed a Decision in this matter on November 12, 1954, which was issued on November 18, 1954. Thereafter, pursuant to Section 1.31 of the Rules of the Commission, Central Electric & Gas Company (Central), Council Bluffs Gas Company (Council Bluffs), and the Metropolitan Utilities District of Omaha (M. U. D.), interveners, acting jointly, and Commission Staff Counsel, filed exceptions to and appeals from the Decision. Oral argument on these exceptions and appeals was heard by the Commission on February 17, 1955.

It is the position of Central, Council Bluffs, and M. U. D.,[1] that Northern's present tariff, which provides

1 This coalition of Council Bluffs, Central, and M. U. D. is hereinafter sometimes referred to as the "Proponents".

uniform system-wide rates to all resale customers, excepting the so-called Argus System,[2] is unduly discriminatory as to them and preferential as to others of Northern's customers; and that the only fair, practical, and equitable means for the elimination of the unduly discriminatory rates is the adoption of service zones and zone rate differentials. The Staff also is of the opinion that Northern's tariff is unduly discriminatory and preferential, and that such discrimination and preference should be eliminated by the fixing of service or rate zones and differentials in rates. The Proponents and the Staff, however, have different views as to the proper boundaries for such zones, as well as the appropriate differentials in rates between zones.

All other interveners participating in the proceeding and Northern are opposed to the establishment of zones. These interveners, the State of Minnesota, City of Minneapolis, City of St. Paul, Northern States Power Company, Minneapolis Gas Company, Minnesota Valley Natural Gas Company, Western States Utilities Company, Iowa Public Service Company and Iowa Electric Light & Power Company[3] joined forces to present evidence and argument opposed to the establishment of zones on Northern's system, and rate differentials.

In the Decision filed November 12, 1954, the Presiding Examiner found and concluded, among other things, that:

"(18) Northern's current uniform system-wide rates, which became effective December 27, 1953, have not been shown to be so unjust, unrea-

2 The area often referred to as the Argus system comprises facilities of Northern in and near the Hugoton Field used for the sale of gas to communities in this area.

3 Sometimes hereinafter collectively referred to as the "Opponents".

sonable, unduly discriminatory or preferential as to constitute a violation of Section 5(a) of the Natural Gas Act.

"(19) The public interest does not now require the establishment of service zones or zone rates upon the interstate natural gas system of Northern Natural Gas Company."

Although having thus stated a negative finding and conclusion as to the main question in the case, the Presiding Examiner expressed in the Decision his findings and conclusions as to other questions which he did not properly reach in view of his recommended disposition of the basic issue. Naturally, since these extraneous expressions of opinion—having the nature of dicta—are opposed to their contentions, the Proponents and the Staff appeal therefrom as well as from the findings and conclusions upon the basic issue.

A proposal to establish zones and rate differentials on Northern's system was previously presented by Council Bluffs in earlier proceedings involving rates of Northern at Docket Nos. G-1382, et al. In our Opinion No. 228 issued June 11, 1952, in those proceedings it was stated (page 31, mimeo. ed.):

"*Zone Rates*: Northern at present has system-wide rates with the exception of its sales in the Hugoton area * * *. Council Bluffs advocated zone rates for Northern's sales. In support of its contention, Council Bluffs presented detailed studies of proposed zones, with cost of service and allocation of costs by zones and proposed specific zone rates. However, on a system as complex as Northern's the determination of proper zone rates, to our mind, requires more thorough and exhaustive study. Other methods of allocating costs between zones might be more reliable than the pipe-line mileage method utilized by Council

Bluffs. Moreover, the delineation of zones requires scrupulous care if such zones are not to be arbitrary or discriminatory. Council Bluffs' witness, who prepared these studies conceded, upon cross-examination, that his use of state lines as zone boundaries was arbitrary and that other boundaries might reasonably be fixed. For the foregoing reasons, and from our examination of the record, we do not believe that there is sufficient evidence before us to determine at this time whether zone rates for Northern's system are in fact proper, and if so, what such zones and such rates should be. There is now pending a proceeding upon a proposed rate increase by Northern in Docket No. G-1881 and we think it appropriate that the problem of zone rates be explored in that proceeding."[4]

Since only limited hearings were held in the proceedings at Docket No. G-1881 mentioned in the above quotation, an opportunity was not there afforded to further develop the matter of zoning. At the first opportunity thereafter presented, being this instant proceeding, Council Bluffs again raised in its petition for leave to intervene the issue respecting the establishment of zones and rate differentials, as did Central. Thereafter, M. U. D. joined with the other two interveners in urging the fixing of zones and rate differentials, and in the joint presentation of evidence in support of this position.

Extensive evidence was presented by the parties favoring the establishment of zones and rate differentials—as well as by those opposed thereto. The Staff of the Commission, although it took no position during the hear-

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4 Upon review, the United States Court of Appeals cited this part of the opinion with approval. **Northern Natural Gas Co. v. Federal Power Commission,** 206 F. (2) 690, 712 affirming F. P. C. Op. No. 228 in pertinent part and reversing in part; cert. denied 346 U. S. 922.

ing in the matter,[5] presented evidence designed to aid in the resolution of this issue. The record made in the sixteen days of hearing devoted to this single question includes 46 exhibits, many of which are quite voluminous, and over 2,000 pages of testimony. There is ample evidence before us at this time upon which to reach a decision, unlike the inadequate state in which we found the record in earlier proceedings where the zoning question was first broached. (See F. P. C. Opinion No. 228, *supra*, page 31.)

Northern's pipe-line system is about 800 miles in length, extending from the Panhandle Field in Texas and the Hugoton Field in Kansas and Oklahoma to a point near the Twin Cities of St. Paul and Minneapolis. In addition to the gas purchased from producers in these fields, Northern also takes delivery of substantial volumes of gas near Wasson, Texas, from Permian Basin Pipeline Company (Permian), a subsidiary of Northern.[6] Permian, in turn, purchases natural gas in the Permian Basin area in west Texas and eastern New Mexico—some 400 miles south of the other fields supplying Northern. Thus, Northern's system is, in effect, extended to a distance of about 1,200 miles.

Natural gas transported through this system is sold to other utilities at points in Kansas, Nebraska, Iowa,

5 At the outset of the hearing on this particular phase of the proceedings, and on several occasions thereafter, Staff Counsel stated that the Staff, as such, would take no position during the hearing either in favor of or in opposition to the establishment of zones on Northern's system. It was stated to be the Staff's purpose in the hearing to secure the development of a comprehensive record upon which ultimate decision could be made by the Commission: First, as to whether zones should be established; and, second, in the event it be found that they should be, an appropriate basis for fixing zones and rate differentials. The Staff first announced its position favoring zones in the initial brief filed herein.

6 Northern owns approximately 83 per cent of Permian Basin Pipeline Company.

South Dakota, and Minnesota for resale to consumers in these states. Through its so-called Peoples Natural Gas Division, Northern also sells directly to consumers in each of these states. Excepting those sales made in and adjacent to the Hugoton Field, in Kansas, the rates charged by Northern for Jurisdictional sales have historically been uniformly available and applicable. And, in proposing the increased rates which initially were the subject of this proceeding, Northern also designed rates to be applied uniformly to all sales for resale in Kansas, Nebraska, Iowa, South Dakota, and Minnesota.

At the time of the hearing in this matter, Northern was serving one distributing company in the State of Kansas. Deliveries to this customer, the Kansas Power & Light Company, are made at 15 separate points requiring transmission through Northern's facilities of distances ranging from 179 to 322 miles from the source of gas supply.[7] These sales in Kansas, however, represented only about 0.35 per cent of the total sales for resale estimated for the year 1954.

Northern, at the time of the hearing, also served twenty-six other utilities at 126 delivery points in the States of Nebraska, Iowa, South Dakota, and Minnesota. These sales constituted 99.65 per cent of Northern's total estimated jurisdictional sales in 1954. Deliveries in these states are made at points on Northern's system ranging from 390 to 803 miles from the source of gas supply.

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7 These mileage computations are based solely on miles of transportation through the facilities of Northern only, and do not include transportation by or for the account of Permian Basin Pipeline Company. In computing the mileage to the several points of delivery there was first determined the weighted average transmission miles of haul from the several sources of gas supply to a common point on Northern's transmission system. This was determined to be at Northern's Bushton (Kansas) Compressor Station, which is the last point of input into the system.

While, as noted, there are 126 of such delivery points, sales at the 8 points shown below represented over 71 per cent of Northern's total estimated jurisdictional sales in 1954.

Delivery Point	Estimated Annual Sales 1954 (Mcf)	Percentage of Total Annual Jurisdictional Sales	Percentage Load Factor of Sales	Weighted Average Miles of Haul—Transmission System
Lincoln	10,866,200	4.63	76.19	447.62
Omaha	26,345,000	11.23	78.27	480.61
Council Bluffs ...	6,053,600	2.58	77.02	483.96
Sioux City	9,826,400	4.19	75.87	560.46
Des Moines	25,352,400	10.81	81.75	625.91
Sioux Falls	7,358,800	3.14	81.10	642.92
Minneapolis	55,013,000	23.45	70.30	795.59
St. Paul	25,922,200	11.05	83.27	803.37
Total.....	166,737,600	71.08	76.41 Ave.	666.65 Ave.
Jurisdictional Sales System Total	234,588,200	100.00	76.38 Ave.	662.00 Ave.

Having in view the facts concerning the mileage of transmission through Northern's facilities required to effect deliveries to these and other points of sales, and considering particularly the fact that the cost of transmission represented 55 per cent of Northern's total estimated cost of service in 1954, as agreed upon in the approved settlement, the Proponents of zoning contend that Northern's present uniform, system-wide rate practice requires communities situated nearer the source of gas supply "to subsidize" those communities located more distant from the source of supply. This, it is argued, subjects the "subsidizing communities" to economic disadvantage and is preferential to others—and is undeniably undue discrimination forbidden by Sections 4 and 5 of the Natural Gas Act.

While conceding that factors other than distance of required transmission should be considered, such as load distribution, volumes of gas sold, and load factor of

sales, the Staff contends that the distance that gas is required to be transported to the points of deliveries is a primary and important cause for the incurrence of transmission costs. Giving consideration to these several factors as related to the system of Northern, it is the position of the Staff that the application of uniform rates and charges throughout the large area served by Northern, exclusive of the so-called Argus System, subjects some of Northern's customers to undue discrimination and grants preference to others. This contention of the Staff is primarily based upon the fact that markets closer to the source of gas supply involve lesser transportation expense than more remote markets, and, therefore, are entitled to a lesser rate—unless it be shown that factors other than distance off-set the differences in transportation mileage and related costs. The Staff contends that there are no such off-setting factors in this case.

The Proponents of zoning likewise contend that where cost of transportation is a dominent factor as it is here, distance is a controlling factor in the absence of other countervailing factors. And, they further contend, there are no such countervailing factors in this case.

As opposed to these arguments, the parties opposed to zoning, including Northern, contend that there should be no change in Northern's long-continued practice of maintaining uniform rates throughout its system, excepting the Argus area, and of "rolling-in" in such uniform rates additional costs as they were incurred. It is said that this practice has been previously "approved and accepted" by the Commission, and that no good reasons have been herein shown for departing from this practice. In furtherance of this point of argument, the Opponents go to great lengths to demonstrate that the large volume of gas distributed on Northern's system, increasing

through the years, has benefited all of Northern's customers through lowered transmission costs. They also urge that the large volume sales made in the upper reaches of Northern's system have benefited customers closer to the source of gas supply, in that such latter customers enjoy a lower unit transmission cost than they otherwise would have without benefit of such sales on the system. From these and similar arguments, the Opponents conclude that by the uniform rate all of Northern's customers share "equitably" in the cost, and, that, therefore, the uniform rate should be continued.

The parties opposing zoning, including Northern, contend also that an increase in rates to some of the distributors occasioned by the establishment of zone rate differentials "will" result in the loss of interruptible industrial sales, and "that the loss of such customers will of necessity cause a raise in the demand charge and thereby all of the firm customers on Northern's system will be injured." The loss of sales, it is said, will result because such an increase in rates will price natural gas out of the competitive market, at least so far as some present industrial consumers are concerned.

Finally, we note the contention of these parties that the proposal to establish zones on this system is untimely and premature because: (1) Northern has pending before this Commission an application for authorization to import gas from Canada as an additional source of supply; (2) Northern, pursuant to limited authorization of the Commission, is exploring the possibility of developing a storage area at a point near its system; and (3) Northern has pending before the Commission applications for authorizations permitting the extension of its system into new markets in Minnesota, Wisconsin, and South Dakota. The Opponents further contend that: "Any one of the

projects upon completion would certainly require another zone study."

We, of course, have not attempted to recite all of the varied arguments advanced by the opposing parties in support of their positions, but we have referred to those which are basic. Further allusion to the variations thereof at this point would not aid in our discussion, nor in an understanding thereof.

Attacking the problem from the rear, the Presiding Examiner first sought to determine which, if any, of the several zoning proposals submitted afforded the most feasible and least discriminatory method of establishing zones for service and rate determination purposes. Having determined that none of the proposals presented was satisfactory, and that his suggested alternative zoning was not wholly satisfactory, the Decision progresses to the point where it is found and concluded that:

> "It is impossible to find under the circumstances, and in view of probable early changes in both markets and sources of supply of Northern, that the present uniform system of rates on the system of Northern is unjust, unreasonable, unduly discriminatory or preferential."

And the Examiner goes on to say that:

> "While it is not believed that the time is now ripe for zoning of Northern's system, it is entirely possible and probable that at some time in the future zoning of the Northern system will be desirable and have the effect at that time of being less discriminatory and preferential than a uniform rates structure for the whole system."

The initial question to be decided, however, is not whether any of the zoning proposals are feasible, but,

rather, whether the present rate structure of Northern is unduly discriminatory or preferential. If the finding is in the negative, as was the Examiner's, then it becomes immaterial whether the proposals as to zone boundaries are proper or not.

To clear the approach to a consideration of this basic question, we would make it clear that we consider the proposals of zoning neither untimely nor premature—if it be concluded that the existing rate practice of Northern is unduly discriminatory or preferential, and, therefore, contrary to the provisions of the Natural Gas Act. The purposes of the Act cannot be thwarted simply because at some indefinite time in the future the present scheme of operations of the system *may* undergo a change by the attachment of new sources of supply, or the extension to new market areas, or the development of gas storage facilities. To hold that effectuation of a primary purpose of the Congress in the enactment of this legislation is dependent upon the fixedness of the operations of the subject company and the improbability of a change in its operations or extension of its facilities would be unreasonable.

The matter before us involves that which is frequently termed a "discrimination case" as distinguished from that which is usually called a "rate case." As so designated, the latter type of case generally involves a determination as to the reasonableness of rates in the sense of whether they are adequate and non-confiscatory or whether they are excessive and unjust. Here we are not concerned with reasonableness in this sense, but rather as to whether rates—otherwise presumed to be reasonable—are unduly discriminatory or preferential. This phase of the proceeding is founded primarily upon sub-

section (b) of Section 4 of the Act which provides as follows:

> "(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service."

These prohibitions against undue preference or advantage, undue prejudice or disadvantage, and unreasonable differences in rates, charges, service, or facilities are implemented by subsection (a) of Section 5 of the Act.[8]

The Natural Gas Act does not attempt to define unlawful discrimination or preference with mathematical precision. Instead it is left to the Commission to primarily decide whether from facts, disputed or undisputed, in a given case preference or discrimination exists;[9] and whether it is of such a nature as to be unlawful within the contemplation of the statute. As the Commission has

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8 The fact that this proceeding was initiated under the primary authority of Section 4(e) of the Act is immaterial. This section provides, in pertinent part, that:

> "* * * after full hearings, either completed before or after the rate, charge classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective."

This refers, of course, to a proceeding initiated under authority of Section 5(a). Thus, the Commission is empowered to grant the relief here requested—if it is found appropriate and proper so to do. **Ayrshire Collieries Corp., et al., v. United States, et al.,** 335 U. S. 573, 581-583.

9 See **United States, et al., v. Chicago Heights Trucking Co., et al.,** 310 U. S. 344, 352-353; **United States v. Louisville & Nashville R. Co.,** 235 U. S. 314, 320.

heretofore found, discrimination or preference may be exhibited in various forms.[10]

The matter now before us involves a determination as to whether unlawful discrimination or preference is created by the exaction from all customers on a transmission system of identical, uniform rates when the points of delivery to the several customers are as much as 600 miles apart. We find, under the circumstances of this case, that Northern's uniformly applicable rates and charges are unduly discriminatory as to some of its customers and unlawfully preferential as to others.

It is a simple economic fact that the delivery cost of natural gas increases in close proportion to the length of the transmission line of any given size. From this Proponents and the Staff reason that it is unreasonable, unduly discriminatory and preferential to charge customers located nearer to the source of gas supply with the same burden of transmission costs as are assessed to customers situated 100, 200, or even 600 miles farther from the source. The charging of uniform rates under such circumstances, it is said, saddles the customers requiring the lesser transportation with costs that are incurred solely for the benefit of customers farther removed from the source of gas—and requiring consequent longer haul. Without more, it would seem that these proponents of zoning for Northern's system have made their case.

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10 E. G., see Opinion No. 225, **In the Matters of Atlantic Seaboard Corp., et al.,** pages 29-32 (mimeo. ed); **In the Matter of Transcontinental Gas Pipe Line Corp.,** 9 F. P. C. 32, 53-54, 63; **In the Matter of Michigan Wisconsin Pipe Line Co., et al.,** 9 F. P. C. 127, 135-136, 150; **In the Matter of San Juan Pipe Line Co., et al.,** 9 F. P. C. 170, 185, 194.

The parties opposed to zoning contend, however, that the factor of distance of transmission is offset by the fact that sales made in Minnesota—the most remote state served by Northern—have benefited customers below Minnesota, in that such customers enjoy a lower unit transmission cost than they otherwise would have without the benefit of such sales on the system. This is but another way of stating the generality that for any given length of pipe line, with any given load factor, the larger the line the lower the unit delivery cost of gas. This results from the fact, as shown by the record here—as well as elsewhere,[11] that, while the cost increases approximately in proportion with the diameter, the capacity increases more than the area, so that the capaciy of a 24-inch line, for example, is about three times that of a 16-inch line.

We, too, are inclined to the opinion that sales in Minnesota benefit the customers elsewhere on Northern's system by contributing to the large volume of gas handled on this system and the lowering of the unit cost of transmission. At the time of the hearing herein, it was estimated that jurisdictional sales in Minnesota in 1954 would total 104,574,000 Mcf, which was 44.58 per cent of the total of such sales. However, it would appear that jurisdictional sales in the other states served by Northern, estimated to aggregate 130,014,200 Mcf in 1954 would make an equal or greater contribution to the lowered cost of transmission—and to Minnesota customers.

In a further effort to develop this theory and to show that customers in the areas of Northern's system are enjoying a lower cost as a result of the sales made in the

11 Docket No. G-580, Natural Gas Investigation, Smith-Wimberly Report, page 240.

farther areas, the so-called Opponents introduced in evidence a laboriously prepared study which purports to reflect the design and costs of constructing and operating a theoretical pipe-line system to serve only those customers in Nebraska, Iowa, and South Dakota. The fundamental purpose of this study, it is said, "was to prove that had any zone under consideration not been served along with the balance of the service area, its service costs would have been higher than they actually are under Northern's presently used uniform rate system." On another occasion, when confronted with similar evidence the Commission said:[12]

> "For the most part the assumptions made either do not square with realities or are patently unreasonable as applied to properties and operating conditions such as those concerned."

The same thing could be said of the similar studies in this case.

In any event, it would seem that the studies prove too much. The single study offered for the record by the group of Opponents purports to show the cost benefits derived by customers outside of Minnesota because of the lowered unit transmission cost resulting from the combined jurisdictional sales in the entire system. This study purports to show that sales from the theoretical system serving only Nebraska, Iowa, and South Dakota would have cost customers in these states 1.57 cents per Mcf more in 1951 and 1.442 cents per Mcf more in 1952 than the actual average cost in these years under Northern's uniform system rates. However, it was developed on the record that the witness who prepared this study had made a similar study of a theoretical line to serve only the State of Minnesota. The latter study indicates

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12 **In the Matter of Canadian River Gas Company, et al.,** 3 F. P. C. 32, 62; aff'd., 324 U. S. 581.

that the Minnesota customers, if served by separate facilities, would have paid 6.21 cents more per Mcf in 1951 and 5.483 cents more per Mcf in 1952 than the actual average cost in these years under Northern's uniform system rates. Thus, even under this approach of the Opponents, which we do not accept or approve, it would appear that the Minnesota customers are the prime beneficiaries under the uniform rate practice of Northern.

As a part of this consideration of the relative contributions made by different markets on the system to the cost of transmission, it is important to consider also the distribution of the load on the system. As shown hereinbefore, eight municipal areas account for slightly more than 71 per cent of the total jurisdictional sales estimated for 1954, *supra,* page 9. As will also be noted, the miles of transportation required to effect the deliveries at these eight points range from 448 to 803. The following tabulation gives a complete breakdown by mileage of the total jurisdictional sales.

Distance in Miles From Source of Gas Supply	Estimated Jurisdictional Sales for Year 1954 (Mcf)	Percentage of Total Jurisdictional Sales
0-400	1,826,400	0.778
401-500	47,520,800	20.257
501-600	20,025,500	8.537
601-700	61,954,900	26.410
701-803	103,260,600	44.018
Totals	234,588,200	100.000

It is of further significance to note that more than 50 per cent of the estimated jurisdictional sales for the year 1954 require transportation through Northern's facilities for distances of less than 650 miles. Considering the data shown in the above tabulation, as well as the more detailed evidence in the record, we find that there

is no such concentration of sales in a single area of the system as would countervail against the arguments of the Proponents and the Staff that the distance of transmission—the mileage of haul—is the primary and controlling factor in the determination of the basic issue here. While it is true that 37.5 per cent of the total estimated jurisdictional sales for 1954 were made at or near the terminus of Northern's system, the distribution of the remainder of these sales along the system is such as to foreclose a finding that sales at the farthest points of the system are so predominate as to be of controlling consideration rather than the distance factor.

We take particular note, too, of the fact that the annal load factor of estimated 1954 sales in Minnesota is lower than the system average for jurisdictional sales and the lowest also of any state served by Northern. The matter of load factor is of importance because for any given length and size of transmission line, delivery cost per Mcf increases as the load factor at which the line is operated decreases.[13] Thus, as hereinbefore noted, while the large volume sales in Minnesota undoubtedly contribute to a lesser unit cost for transmission, the lower load factor of such sales has a converse tendency.

During its long administration of the Interstate Commerce Act, the Interstate Commerce Commission has often had occasion to pass upon matters similar to those here involved. While the Interstate Commerce Commission in its regulation of the railroad and motor carriers

13 This generality simply gives expression to the mathematical fact that more complete utilization of any given capital facilities involving fixed costs will result in declining unit costs. Docket No. G-580, **National Gas Investigation, Smith-Wimberly Report,** page 260; **Hamilton, Cost as a Standard for Price,** 4 Law and Cont. Prob. 321, 330.

of the nation must often consider other factors which are generally foreign to the natural-gas industry, in proceedings involving haul and place relationships that Commission gives principal consideration to the factors of distance and competition between carriers. The Commission's regard of these factors in this type of proceedings has been well stated as follows:[14]

> "While there is no easy index of rate-paying ability, cost of service obtrudes itself in an obvious and inescapable form through the element of distance. The length of the haul is a physical fact which provides an objective measure of the amount of service rendered; and although cost does not vary in direct proportion to distance (any more than ability to pay varies in direct proportion to the value of commodities), even a rough application of the distance principle tends to improve the most questionable rate relationships, and reasonable refinements can readily be made where they are needed. Accordingly, the element of distance as an index of the cost and worth of transportation service appears to have commended itself to the Commission as a leading consideration for reasons of its easy ascertainment and popular appeal as a fair standard, as well as because of the more substantial economic grounds which support its recognition. Despite many evidences of the Commission's inclination to observe that cost is only one of a number of significant factors in rate-making, it does not appear that in the adjustment of charges between hauls any other criterion has been set up as a positive guide in the processes of rate control.
>
> Broadly regarded, then, the vast number of rate proceedings involving haul and place relationships lend themselves to a fairly uniform pattern of analysis. The principal factors to be considered have generally been distance and competition [between car-

14 Vol. III-B, Sharfman, The Interstate Commerce Commission, pages 541-542.

riers]. The basis of complaint has commonly consisted of an apparent failure to adjust charges in sufficiently close conformity to the length of the haul or of some related cost element, the extenuating circumstances urged as justification of rate adjustments which disregard distance have commonly consisted in the exigencies of competition or of some related condition involving the need of attracting traffic. As already noted, these considerations—distance and competition—have operated on different levels: the one as a positive standard to which closer conformity may be required; the other as a plausible ground for permitting departure from this standard."

To a similar effect, we note the statements on this subject by another authority, which has been cited to us by the Opponents:[15]

> "The [Interstate Commerce] Commission has always recognized distance, however, as a most important consideration in rate making and has said that, as a general rule, other things being equal, distance should be a controlling factor, and rates between distant points should exceed those between points less distant. Distance, however, has never been regarded as the sole consideration. As said by Commissioner Prouty 'Rates cannot be made with a yard stick.' Where, therefore other circumstances are present which outweigh the importance of the length of the haul, either as affecting the cost or the value of the service, it has held that distance may properly be disregarded."

Our position in this proceeding is thus in general accord with the position taken by the Interstate Commerce Commission in similar matters which has so often been approved in the courts.

As previously stated, it is a simple economic fact that the delivery cost of natural gas increases in close propor-

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15 I. Drinker, Interstate Commerce Act, §58 (1909).

tion to the length of the transmission line of any given size. Therefore, unless other circumstances are present which outweigh the importance of the length of transmission required to effect delivery, the distance factor is the prime determinant of the cost of rendering service. Since in our view of this record there are no such circumstances present to counter-balance the distance factor, we conclude that the distance of transmission required to effect deliveries at the various points of sale by Northern reflects with reasonable accuracy the relative cost of providing service to its customers. We further find and conclude that Northern's present practice of demanding and collecting uniform rates throughout the length and breadth of its area of service for the sale of natural gas for resale is unjust, unreasonable, unduly discriminatory, and preferential. This practice results in the shifting of transmission cost from those whose service requires its incurrence by reason of the greater transportation distances to others who are not responsible for such cost—and who are not benefited correspondingly.

Having found and concluded that Northern's present uniform rate practice is unlawfully discriminatory and preferential, there is to be determined the manner in which the discrimination and preference may be most properly eliminated. In theory, the ideal, non-discriminatory, and non-preferential rate structure would be one designed to assess each point of sale and delivery with the total of the various cost components incurred in the rendering of service to each point. But any attempt to arrive at such perfection would be not only delusory,[16] but

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16 **Colorado Interstate Gas Company v. Federal Power Commission, et al., 324 U. S. 581, 589; Hamilton, Cost as a Standard of Price, supra; Op. No. 225, In the Matter of Atlantic Seaboard Corporation, et al., pp. 17-19 (mimeo. ed.).**

also impracticable and infeasible from both the management and regulatory point of view. In the circumstances of this case, the only practical and reasonable approach to an equitable solution is the establishment of service zones—with rate differentials—as urged by the Proponents of zoning and the Staff.

The Proponents of zoning recommend the establishment of two zones on Northern's system, exclusive of the so-called Argus System which is sometimes referred to as a zone. The boundary lines, under this recommendation would be established at the suction side of the Oakland (Iowa) Compressor Station on the east branch of the system and the suction side of the Hooper (Nebraska) Compressor Station on the west branch.

The staff witness presented in evidence four different possibilities of zoning for Northern's system.[17] These several suggested methods of establishing zones may be summarily described as follows:

> Proposal A—Boundary lines between zones 1 and 2 to be established at the Bushton (Kansas) Compressor Station. Boundary lines between zones 2 and 3 to be established at the Hooper Compressor Station on the west branch and at the Oakland Compressor Station on the east branch of the system.
>
> Proposal B—Boundary lines between zones 1 and 2 to be established at the Kansas-Oklahoma border. Zones 2 and 3 to be separated by a line running through the Beatrice (Nebraska) Compressor Station. Zones 3 and 4 to be separated by dividing lines at the Paullina (Iowa) Compressor Station on the west branch and the Ogden (Iowa) Compressor Station on the east branch.
>
> Proposal C—Under this plan each of the states through which Northern's system extends would con-

17 As noted hereinbefore, the Staff, as such, did not take a position on the zoning issue during the course of the hearing (Fn. 5 supra).

stitute a separate zone as follows: Zone 1—Oklahoma, Zone 2—Kansas, Zone 3—Nebraska, Zone 4—Iowa, Zone 5—South Dakota, and Zone 6—Minnesota.

Proposal C Modified—A modification of Proposal C to establish additional sub-zones in the states of Nebraska and Iowa having boundary lines equidistant from the source of gas supply.

The Staff, as such, recommends the so-called Proposal B, as briefly described above. In expressing his individual opinion, as distinguished from the collective opinion of the Staff, the staff witness stated the so-called Proposal C Modified to be most suitable for Northern's system.

The Presiding Examiner found and concluded that:

"(12) The most feasible method of zoning the system of Northern, as it existed prior to construction of the facilities authorized in Docket No. G-2063, would be obtained by the creation of an A or Argus Zone, extending from the southern end of Northern's system to the Bushton compressor station and a division of the remainder of the system into two zones at a point far enough north of the Ogden, Iowa, and Paullina, Nebraska, compressor stations to fix (without question) in the southernmost of said zones the delivery points from the main line to the Waterloo-Dubuque and Boone-Marshalltown laterals connected to the Ogden station and the Sioux Falls lateral connected to the Paullina station."

Both the Proponents and the Staff have taken exception to this finding of the Examiner, each urging approval of the particular zoning proposal recommended by them.

After detailed consideration of the record, we have concluded that none of the zoning plans presented by the

Proponents and the Staff or the modified plan which the Examiner finds most feasible are appropriate and acceptable. While each might as claimed tend to eliminate or reduce the discriminations and preferences existing under the present rates of Northern, the facts are clear that other inequities would be created by the establishment of zones according to any of these plans.

Under each of these plans, including that found most proper by the Decision, determination of the zone in which a particular sale is made would be fixed by the point on the main line from which the lateral line enabling such sale takes off. All of Northern's sales of gas for resale are effected at the city gates of the communities served. In most instances these sales are made at the terminii of lateral lines branching from the main line transmission facilities. Thus, the total distance of transmission to each point of delivery is represented by the aggregate of the mileage of transmission through both the main line and the lateral line serving each point of sale. As a result, as is elaborately pointed out by the Opponents, under each of these methods of zoning the total mileage of transmission to certain points in zones closer to the source of supply is greater than the mileage to other points of sale in zones farther removed from the source. Under each of the plans considered, including the Examiner's, deliveries to certain points requiring the greater mileage of transmission would be made at the lesser rate.

The foregoing is sufficient in our view to condemn each of these methods of zoning. Therefore, it would serve no useful purpose to relate in exhaustive detail other infirmities which we find, but brief additional comment would be illustrative. The zoning proposed by the

Proponents would result in a wholly disproportionate division of the principal market territory. Under this plan Zone 1 sales would represent only about 22 per cent of the total jurisdictional business, whereas approximately 78 per cent of these sales would be included in Zone 2. Moreover, under this plan, Zone 1 sales would assume a relatively small and disproportionate portion of the costs associated with the hundreds of miles of lateral lines on the system. These same points of criticisms are also appropriate for the Staff's so-called Proposal A, which is substantially similar to the plan of the Proponents excepting that an additional zone is proposed south of the Bushton station.

The establishing of a separate zone for each state, as contemplated in the Staff's Proposal C, is a method which has been employed by other natural-gas companies. However, it is wholly inappropriate and would be inequitable on Northern's system, particularly because of the geographical relationship of the facilities to the boundary between the States of Nebraska and Iowa. Staff's Proposal C Modified is also unsatisfactory, not only for reasons hereinbefore stated, but also because it would provide for the establishment of too many zones on this system, particularly in the principal market area which is about 400 miles in length and about 300 miles between the westernmost and the easternmost points of sales. We believe that zones should include as large an area of service as may be consistent with equitable treatment to all customers. Furthermore, this plan more than any other suggested would be responsive to any change of markets or facilities so as to necessitate possibly the establishment of other zones or sub-zones.

Considering the foregoing, and all other facts of record, it is our opinion that the most appropriate and

practicable method would be the establishment of three zones on Northern's system with zone boundaries as depicted on the map following this page.[18] (Illustration in this instance is more desirable—and more effective—than description.) This plan, in our view, provides the most effective and equitable basis for eliminating the present unlawful descrimination and preference.

18 These three zones encompass the whole of Northern's system north of the Oklahoma-Kansas boundary, which is the area in which all of its sales are made. It would seem appropriate also to designate the area south of the Oklahoma-Kansas line where Northern has facilities as "Zone A."